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HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 321

J. J. DIX, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BERNARD WEISS,
Counsel for Petitioner,
136 East 57th Street,
New York 22, N. Y.

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IN THE

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J. J. DIX, INC., *Petitioner,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled proceeding on June 2, 1955.

Citations to Opinions Below

The findings of fact and opinion of the Tax Court of the United States (R. 9-38) printed in Appendix A hereto *infra* pp. 17-46, is reported unofficially in 12 T. C. M. 536. The opinion of the Circuit Court of Appeals (R. 54-58) printed in Appendix A hereto *infra* pp. 42-45, has not yet been officially reported.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on June 2, 1955 (R. 61) Appendix A, p. 47, *infra*. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1).

Questions Presented

I.

Where a non-stockholding President of a corporation commits an independent fraud for his own benefit by misappropriating funds entrusted to him to be spent for corporate purposes, such funds coming from sales, which the President caused to be omitted from the corporate books and tax returns without the knowledge or consent of the other officers and stockholders, can such fraud be attributed to the corporation so as to make it liable for the 50% fraud penalty in accordance with Section 293(b) of the United States Internal Revenue Code of 1939, where neither the stockholders nor the corporation benefited from such action?

II.

If the unauthorized acts of the President are not chargeable to the corporation, is not Section 275(a) of the United States Internal Revenue Code of 1939, pleaded by petitioner as an affirmative defense, a bar to the assessment of income and excess profits taxes for the years 1938 to 1942 inclusive, where the deficiency notice was mailed long after the statutory period of assessment had expired?

III.

Where the court below sustains the action of the Tax Court of the United States which found as a fact that large amounts of money were spent for overceiling payments for waste paper to obtain a supply of paperboard needed to manufacture paperboard boxes and which constituted part of the cost of goods sold in accordance with Section 29.22(a)5 of the U. S. Internal Revenue Regulations 111,

may the Court refuse to make any allowance on the ground that a computation of such cost is too difficult or speculative?

IV.

Where a stipulation was entered into between the petitioner and the respondent agreeing that the taxpayer paid amounts of additional compensation to office and factory personnel and where the Tax Court of the United States finds that amounts paid to factory personnel are allowable as part of cost of goods sold, is the court below justified in sustaining the action of the Tax Court in its refusal to make an allocation of such payments between office and factory personnel because such allocation may be difficult or speculative?

V.

Where the Tax Court of the United States and the U. S. Court of Appeals for the Second Circuit find that the President of a corporation embezzled funds of such corporation, no part of which funds inured to the benefit of the corporation or its stockholders, nor was condoned by them, is not the corporate petitioner entitled to deduct the loss by embezzlement under Section 23(a) or (f) of Internal Revenue Code of 1939 either in the year of discovery, in accordance with the decision of the U. S. Supreme Court in the companion cases of *Alison* v. *United States* and *Stevenson-Chislett, Inc.* v. *United States,* decided Dec. 8, 1952, 344 U. S. 167, or years of actual loss where such years are still open?

Statutes

The pertinent provisions of the United States Internal Revenue Code of 1939, adopted by Act of February 10,

1939, Ch. 2, 53 Stat. 1-504 and Regulations applicable thereto are set forth in Appendix "B".

Statement

Petitioner duly filed its petition for a redetermination of its income, declared value excess profits tax and excess profits tax liability with the Tax Court of the United States for the calander years 1938 through 1945 inclusive. The Tax Court of the United States had jurisdiction over the proceeding in the first instance, in accordance with Section 272(a), United States Internal Revenue Code of 1939. The Tax Court of the United States rendered its findings of fact and opinion on May 20, 1953 (R. 9-38) Appendix A, pp. 11-40, *infra,* and entered its decision on October 20, 1953 (R. 39) Appendix A, p. 41, on the basis of the pleadings, oral testimony, arguments and briefs.

It was determined by the Tax Court of the United States that out of $196,870.60 of sales which were deposited in two corporate bank accounts which were not recorded on the books and tax returns of the corporation for the years 1938 to 1944 inclusive, that the petitioner realized $62,054.23 of additional income for said years and that the failure to report such taxable income constituted fraud and therefore the petitioner-corporation was liable for the 50% fraud penalty under Section 293(b) of the United States Internal Revenue Code of 1939 (R. 38) Appendix A, p. 40. With this finding the Court below agreed (R. 57) Appendix A, p. 44.

The Tax Court of the United States was sustained by the Circuit Court of Appeals in its determination not to allow as deductions amounts of money paid by the corporation to its non-stockholding president, approximating $56,800, for payment of $25,000 to wastepaper dealers in

excess of OPA ceiling prices, $28,800 unauthorized wage increases to factory personnel and $3,000 cash commissions in excess of amount allowed by the Tax Court of the United States (R. 28, 29, 30, 56) Appendix A, pp. 30, 31, 32, 43, 44. The $62,100 of alleged omitted taxable net income consisted of the said $56,800 and $5,300 paid to another officer to reimburse him for payments made by personal check to office and factory personnel as additional compensation, which the respondent disallowed as being increases in compensation unauthorized either by the National War Labor Board or the Salary Stabilization Board.

The Tax Court of the United States, while stating that the part of the compensation paid to production personnel was deductible as part of cost of goods sold, made no allowance whatsoever for failure of proof. (R. 29) Appendix A, p. 31. The Circuit Court agreed with this finding (R. 56) Appendix A, p. 44.

The Tax Court of the United States determined that the $56,800 given to the president to be spent for corporate purposes were not so spent, and that this sum had been misappropriated by the president without the knowledge or consent of the other officers or of the stockholders (R. 31, 36-38) Appendix A, pp. 33, 38-40. With this conclusion the court below was in agreement (R. 56, 58) Appendix A, pp. 44, 45.

The Tax Court of the United States in its opinion stated that though the corporation may be entitled to a loss from embezzlement, it could make no allowance because it could not, from the record, determine either the exact amount of the embezzlement or how much was to be allowed in any given year (R. 31, 32) Appendix A, pp. 33, 34. With this conclusion the United States Court of Appeals was in agreement (R. 57) Appendix A, p. 44.

Despite the fact that the Tax Court of the United States determined that the president's fraud was discovered in 1945 (R. 32, 34) Appendix A, pp. 34, 36, neither the Tax Court nor the court below mentioned or considered the decision of the United States Supreme Court in the companion cases of *Alison* v. *United States, Stevenson-Chislett, Inc.* v. *United States,* 344 U. S. 167. These latter cases determined that the embezzlement loss could be deducted in the year of discovery (Appendix "C", p. 5[illegible]).

The Tax Court of the United States determined that the president of the corporation caused the sales to be unrecorded either on the books or on the corporate tax returns in order to prevent discovery of his misappropriation (R. 37, 38) Appendix A, pp. 39, 40. With this conclusion the Circuit Court was in agreement (R. 5[illegible]) Appendix A, p. 45.

The Tax Court of the United States considered the acts of the president who signed the corporation tax returns as binding on the corporation and that his fraud was to be considered the fraud of the corporation (R. 37, 38) Appendix A, pp. 39, 40. With this conclusion the United States Court of Appeals agreed (R. 57) Appendix A, p. 44.

Reasons for Granting the Writ

1. The decision of the Circuit Court sustaining the action of the Tax Court of the United States in this proceeding is believed to be the *first* case of its kind to reach the United States Supreme Court wherein a corporation is held liable for the 50% fraud penalty for the action of a non-stockholding president who committed an independent fraud for his own benefit by embezzling funds entrusted to him to be spent for corporate purposes, such funds coming

from sales which the president caused to be omitted from the corporate books and tax returns without the knowledge, authorization or consent of the other officers and stockholders, and where neither the stockholders nor the corporation benefited from such misconduct.

In fact, in the consolidated case of Estate of Jacob J. Dix, the court below stated "Jacob withdrew those moneys from the corporate bank accounts without the consent, coerced or otherwise, of the company. *That he was the president did not amount to corporate consent.*" (R. 58) Appendix A, p. 45, *infra*. (Emphasis supplied)

2. The action of the court below in holding a corporation liable for the unauthorized and illegal acts of its president is believed to be contrary to the fundamental principles of the Law of Agency as expressed by the Court of Appeals of the State of New York in the case of *Credit Alliance* v. *Sheridan Theatre Co.*, 241 NY 216, where it stated, among other things, i.e. "* * * when an agent abandons the object of his agency and acts for himself by committing a fraud for his own exclusive benefit he ceases to act within the scope of his employment and to that extent ceases to act as agent."

The petitioner, being a New York corporation, the rule expressed herein would be applicable to it and clearly the rule of responsibility of principal for acts of agents, as set forth by the Tax Court of the United States and approved by the Circuit Court in this proceeding is in direct conflict with the New York State Law as expressed by the highest court of the State of New York in *Credit Alliance* v. *Sheridan Theatre Co., supra*. It is believed that income tax cases do not require or justify an exception to so fundamental a principle of law.

3. The judgment of the court below in refusing to follow its own decision in *Cohan* v. *Commissioner*, 39 F. (2d) 540 (Appendix "D", pp. 56, 57), which decision has been cited with approval in the First, Fourth, Seventh, Ninth and Tenth Circuits in the cases of *Marx* v. *Commissioner*, 179 F. (2d) 943; *Harris* v. *Commissioner*, 174 (2d) 73; *Sammons* v. *Commissioner*, 179 F. (2d) 839; *Roberts* v. *Commissioner*, 176 F. (2d) 221; *Cohen* v. *Commissioner*, 176 F. (2d) 399, respectively. The *Cohan* decision was followed by the court [redacted] in the case of *Waterman's Estate* v. *Commissioner*, 195 F. (2d) 244. These decisions create an apparent conflict in legal principles as applied by the court below.

In the decision in the *Cohan* case, *supra*, it was held that " * * * the Board (now the Tax Court) should make as close an approximation as it could, bearing heavily, if it chooses, upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying something was spent." Appendix D, pp. 56, 57.

In failing to make any allowance whatsoever for payments the Tax Court of the United States found were made to production personnel, and in failing to make any allowance for overceiling payments to wastepaper dealers, both of which items the Tax Court of the United States found were part of cost of goods sold and were deductible, the court below disregarded its own admonition that the Board should make its best estimate (App. D, p. 56). That such items form part of cost of goods sold and are allowable deductions from gross income are supported by such cases as *Lela Sullenger*, 11 T. C. 1076, aff'd. CCA 5th; *Hofferbert* v. *Anderson Oldsmobile, Inc.*, 197 F. 2d 507 (CAA 4th); *Jones* v. *Herber*, 198 F. (2d) 554 CAA 10th; *Commissioner* v. *Weisman*, 197 F. (2d) 222, CCA 1st; and

Commissioner v. *Guminski,* 198 F. (2d) 265, CCA 5th. Furthermore, the Commissioner of Internal Revenue has acquiesced in the decision in the *Lela Sullenger* case, *supra,* (1952-2 C. B. 3)

The Court of Appeals for the Third Circuit, in *Commissioner* v. *Murray Thompson et al,* 11370, 11371, 11373, decided May 27, 1955, not officially reported as yet, aptly stated the governing rule when it said: "It is the function of the trier of fact to weigh all the elements properly considered in the valuation and to translate them into dollars and cents. If there is speculation in this, it is a product of the nature of the problem but not a reason for abdicating the judicial function which in the administration of justice is frequently called upon to appraise intangibles."

4. The court below, in affirming the action of the Tax Court of the United States in its finding that the president, without the assistance of the stockholders or other officers, had misappropriated funds of the corporation and that such fraud was discovered in 1945, came to an improper conclusion as a matter of law that such loss was not deductible by the corporate petitioner in the year of discovery or years of actual embezzlement pursuant to Section 23(a) or (f) of U. S. Internal Revenue Code of 1939. The court below further improperly disallowed the loss from embezzlement for the failure to prove that the amount misappropriated could not be recovered from the decedent's estate.

Where, in order to recover from the Estate amounts embezzled by the decedent, it is necessary to litigate and establish the claim, it is requiring the petitioner to be an incorrigible optimist to assume, first, it will establish the

full amount of the claim in a contested action and second, that the Estate will have sufficient funds, considering the amount of the gross estate and the administration expenses and other prior claims, to pay such judgment.

It is fundamental in the administration of the tax laws that mere claims shall not be considered as giving rise to taxable income until such claims have been acknowledged by judgment or otherwise to be valid and subsisting. Further, there is no such presumption of law that claims are taxable income even before they have been asserted or were known to exist. In fact, this Court, in *U. S.* v. *Safety Car Heating Co.*, 297 U. S. 88 (56 Sup. Ct. Rep. 353, 354), held in effect that uncollected income which is the subject of any important contest, dispute or controversy does not become taxable income until such time as the differences are resolved.

Conclusion

For the foregoing reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

BERNARD WEISS,
Counsel for Petitioner,
136 East 57th Street,
New York 22, N. Y.

APPENDIX A

(R. 664)

THE TAX COURT OF THE UNITED STATES

J. J. DIX, INC., Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

MONROE L. DIX, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

ESTATE OF JACOB J. DIX, Deceased, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket Nos. 26251, 26250, 26252

1. *Held,* business expenses paid by a corporation out of a fund representing unreported gross income must be deducted in determining the correct net income of the corporation.

2. *Held,* estimates of amounts paid over ceilings of prices and wages may not be included in cost of goods sold in the absence of evidence establishing the amounts so paid.

3. *Held,* an individual taxpayer may not be charged with a percentage of corporate income because of ownership of that percentage of corporate stock in the absence of evidence that he received such income.

(R. 665)

4. *Held,* deficiencies determined more than three years after the filing of tax returns are barred by the

statute of limitations in the absence of fraud, waivers or other statutory bases for extension of the period.

5. *Held,* corporate funds taken by an officer of the corporation for his own purposes by means of fraud and his dominant position are not exempt from tax as income.

6. *Held,* the respondent is sustained in his determination that all or part of the deficiencies determined against the president of a corporation and the corporation itself were due to the fraud of the president, individually, and as agent, with intent to evade tax.

Sidney Gelfand, Esq., and *Bernard Weiss, Esq.,* for the petitioners.

Clay C. Holmes, Esq., for the respondent.

Memorandum Findings of Fact and Opinion

The respondent determined deficiencies and additions to the tax as follows:

J. J. Dix, Inc.

Year	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax	50 Per Cent Fraud Penalties
1938	$ 1,312.77	$ 328.99	—	820.89
1939	2,987.05	2,527.78	—	2,897.58
1940	2,442.75	1,848.76	—	2,483.90
1941	14,804.32	7,879.17	$11,905.44	18,586.88
1942	6,432.11	—	(650.10)	5,097.32
1943	6,007.82	6,250.14	41,633.09	26,945.53
1944	7,367.50	—	23,803.57	15,585.53
1945	7,056.21	—	(22,667.94)	—

(R. 666)

MONROE L. DIX

Year	Income Tax	Penalties
1938	$ 92.21	$ 46.10
1939	1,530.19	765.10
1940	1,813.42	906.71
1941	3,680.62	2,207.32
1942	2,376.07	1,188.04
1943	3,328.90	1,669.86
1944	13,979.26	6,989.63
1945	21,790.77	10,895.39

JACOB J. DIX

Year	Income Tax	Penalties
1938	$ 123.67	$ 89.70
1939	1,177.73	641.96
1940	5,078.71	2,539.36
1941	7,859.55	4,090.06
1942	5,955.42	2,977.71
1943	2,039.79	857.95
1944	23,467.05	11,733.53
1945	14,425.13	7,212.57

The questions presented relating to petitioner, J. J. Dix, Inc., are whether it realized additional net income of $196,870.60 during the years 1938 through 1944 which was not reported on its tax returns; whether it is entitled to additional deductions for selling and traveling expenses in the years 1942 through 1945; and whether the respondent erred in increasing the income of J. J. Dix, Inc. by inventory adjustments in 1941, 1942 and 1943. Questions

relating to Monroe L. Dix are whether he derived taxable income of $81,242.11 as distributions from J. J. Dix, Inc. in the years 1938 through 1945 and whether the respondent erred in adding $10,100 from unidentified deposits to his 1939 income. Another question presented is whether Jacob J. Dix derived taxable income of $121,834.89 during the years 1938 through 1945 as a result of distributions from J. J. Dix, Inc. Further questions are whether the deficien-

(R. 667)

cies determined by the respondents in income taxes, declared value excess profits taxes and excess profits taxes of the petitioners for the years 1938 through 1942 are barred by section 275, I. R. C. and whether the petitioners filed false and fraudulent tax returns for the years 1938 through 1945 with intent to evade taxes.

Findings of Fact

The facts stipulated are found accordingly.

The petitioner, J. J. Dix, Inc., hereinafter sometimes referred to as the corporation, incorporated in 1917 under the laws of the state of New York under the name of Port Morris Box Co., Inc., was engaged in the manufacture of paper boxes. The name of the corporation was changed to J. J. Dix, Inc. in January 1925. The original shares of capital stock, after transfer of incorporators' shares, were issued on February 14, 1917, as follows:

Jacob J. Dix	4 shares
Bertha Dix (the spouse of Jacob J. Dix) ..	396 shares

At the time Bertha Dix died in 1935, she still owned 396 shares of the corporation's stock. She had told her son Monroe Dix (hereinafter sometimes referred to as Monroe) that she would leave her stock to him and that he should look after his sisters and his father. After she died, no will was found and the capital stock of the corporation was allocated in 1938 one-third to Monroe Dix, one-third to his two sisters and one-third in irrevocable trust to Monroe Dix with dividends to Jacob Dix (hereinafter sometimes referred to as Jacob) while the latter was alive.

(R. 668)

This allocation was accomplished on November 19, 1938, when the 400 shares of capital stock were placed in a voting trust. Voting trust certificates were issued as follows:

Name	Shares
Jacob J. Dix	133⅓
Florence Kronsky	66⅔
Rose Selby	66⅔
Monroe Dix	133⅓

On November 19, 1938, simultaneously with the receipt of the voting trust certificates, Jacob J. Dix transferred to a newly created trust, of which his son, Monroe Dix, was the remainderman, the voting trust certificate for 133⅓ shares of J. J. Dix, Inc. On October 20, 1944, by consent of all parties, the voting trust certificates, previously issued, were cancelled and new voting trust certificates were issued as follows:

Name	Shares
Jacob J. Dix	100
Florence Kronsky	50
Rose Selby	50
Monroe Dix	200

The voting trust certificates for 100 shares issued to Jacob J. Dix were then placed in a trust of which Monroe Dix was the remainderman, replacing the voting trust certificate for 133⅓ shares previously placed in trust.

Monroe Dix was vice president and a director and in charge of sales of J. J. Dix, Inc. from 1938 to 1945. Jacob Dix was president and treasurer of the petitioner corporation. The corporation's regular bank account was with the Manufacturers Trust Co. In 1938 the corporation opened a bank account with the Sterling National Bank

(R. 669)

and Trust Company because the head of the Bank was a personal friend of Jacob Dix. This bank account was closed in 1942. An account with the Public National Bank was opened in 1943 and closed in 1945. Deposits in these two banks aggregating $196,870.60 were made in the years 1938 through 1944 which were not reflected on the corporation's books nor included on its tax returns. The deposits in these accounts represented sales proceeds of merchandise manufactured by the corporation in the regular course of business. Included in the deposits of $196,870.60 of omitted sales was the amount of $5,200, the proceeds of a sale of a machine belonging to another corporation.

All checks drawn on the Sterling National Bank and Public National Bank accounts were signed by Jacob and/or Monroe and a substantial number of checks were drawn to the order of Jacob and/or Monroe or to cash. The parties agree that a total of $5,486.87 in the following amounts were disbursed from these two bank accounts and represent allowable deductions:

Blyco Paper	1940	$ 475.62
Bedford Robbins	1941	206.78
M. Schild	1941	154.50
Freida Weiss	1942	1,000.00
Quality Art Novelty Co.	1943	3,000.00
M. Schild	1944	400.00
Monroe Paper Box Co...	1944	249.97

The deposits were made in the Sterling National Bank account rather than the Manufacturers Trust Company because Jacob did not wish the latter bank to know the firm had another account. Jacob drew numerous checks on the corporation's account at the Sterling National Bank and deposited the funds in his own bank account at the Bronx

(R. 670)

County Trust Company. Monroe, who drew checks on the corporation's account in the Manufacturers Trust Company at various times, also drew checks on the Sterling National Bank account and other banks and turned the funds over to his father. Monroe had no personal knowledge of how his father spent this money. From 1939 to 1944 Monroe also drew checks in excess of $33,000 on his own bank accounts payable to Jacob which were deposited in Jacob's personal accounts.

During the years 1939 through 1942, Monroe drew checks aggregating $27,750 on the corporation's account with the Sterling National Bank and deposited them in his own bank account and then within a few days drew exchange or replacement checks for a similar amount to the order of the corporation. These latter checks were deposited by the corporation in its regular bank account with the Manufacturers Trust Company. In 1939 the sum of $3,000 in checks was received by the corporation. In 1940 the

sum of $11,250 was received and in 1941 and 1942, $10,500 and $3,000, respectively, were received. Jacob drew checks aggregating $13,500 on the corporation's account with the Sterling National Bank in 1939, 1940 and 1941 and deposited them in his own bank account. Shortly thereafter he drew "exchange checks" amounting to $13,000 to the order of the corporation which were deposited by it in its regular bank account. In 1939, $2,500 was received by the corporation in exchange checks from Jacob. In 1940, $8,000 was received, and $2,500 was obtained in 1941. The amount received by the corporation from Jacob and Monroe by exchange or replacement checks were not credited to special accounts but were recorded as cash sales. The corporate records and bank accounts balanced during the

(R. 671)

period of these deposits. The amounts withdrawn by Jacob and Monroe were not reflected on their Federal income tax returns nor were they reflected in the net worth of either. Monroe did not keep for himself any amounts withdrawn on the Sterling National and Public National Banks. The exchange checks drawn by Monroe were never paid back to him by the corporation. In addition to the aforementioned exchange checks, Monroe drew the following checks to J. J. Dix, Inc.:

Date	Amount
10/24/39	$ 5,000.00
6/29/40	3,000.00
4/14/42	3,000.00
12/18/45	26,244.05
12/18/45	3,135.45

In December 1945 exchange checks from Monroe for $26,244.05 and $3,135.45 were deposited by the corpora-

tion in its regular bank account and credited to sales income on corporate books and reported as such in its tax returns. Also in December 1945, the corporation received $34,000 United States Treasury bonds purchased with funds from the Public National Bank account for which amount sales were credited on the corporate books and reported as such on its tax returns.

In 1943, 1944 and 1945, the supply of paper board necessary to manufacture boxes was very limited and many mills were not operating at capacity because of the shortage of wastepaper. The supply of wastepaper was controlled by wastepaper dealers and it was common practice in the industry during these years to have wastepaper dealers deliver wastepaper board to paper board mills which would then allocate a supply of paper board to various box manufacturers. Cash was paid to the dealers to induce them to

(R. 672)

deliver the wastepaper to the mills. Dealers delivered wastepaper to mills for the credit of J. J. Dix, Inc.

The Continental Paper Company, a manufacturer of paper board, received between 600 and 700 tons of wastepaper in 1943, 447 tons in 1944 and a small amount in 1945 from scrap dealers for the credit of J. J. Dix, Inc. The Continental Paper Company sold 613 tons of paper board to the corporation in 1943, 860 tons in 1944 and 367 tons in 1945. This paper board was allocated to the corporation by wastepaper dealers who sent the scrap paper to the Continental Paper Company. The latter company supplied 25 per cent to 35 per cent of the paper board requirements of J. J. Dix, Inc. The Continental Paper Company, although approached by numerous persons who offered to sell wastepaper at prices above the ceiling of $15 a ton, refused

to buy under these conditions and paid only the ceiling price. It was common knowledge in the trade that many customers of the Continental Paper Company were paying sums of money over the ceiling price to the waste paper dealers for paper stock. The shippers of such wastepaper were not usually regular customers of the Continental Paper Company. The Continental Paper Company felt obligated to deliver the paper board to the company designated by the shipper after making a reservation in the paper stock to cover shrinkage and the amount put aside for the federal government. The practice of the wastepaper shipper designating a manufacturer of paper board was not a common trade practice but existed only during the years 1943, 1944 and 1945 when supplies were inadequate. A union official recommended to Jacob a source from which he could obtain wastepaper. An over ceiling price was required to

(R. 673)

be paid and the amount varied from $5 to $15 per ton. Monroe never saw his father pay paper dealers in excess of ceiling prices.

The percentage of gross profit reported by the corporation during the years in question, after inventory adjustments by respondent, were as follows:

1938	35.89%
1939	40.22
1940	31.11
1941	37.04
1942	35.99
1943	36.67
1944	33.13
1945	41.98

The corporation was a member of the National Paper Box Manufacturers Association from 1942 through 1945. The percentage of gross profit during these years, of members of the association in the United States, varied from 22.82% to 24.41%. Members of the association in the eastern division received gross profit percentages averaging from 21.76% to 28.13% during the same years.

In 1943, 1944 and 1945, the corporation employed between 80 and 130 persons. Of these, four or five were office workers under the supervision of Monroe. The balance were factory workers. In these years, Monroe paid additional salaries amounting to $5,317.41 from his personal checking account to certain employees of the corporation. In 1943 he paid $1,799.76. In 1944 a total of $3,317.65 was paid by Monroe and in 1945 a $200 payment was made. He was reimbursed for these payments by checks drawn on the Public National Bank account of the corporation. These amounts paid by Monroe to employees were not approved

(R. 674)

by the Wage Stabilization Board. Monroe did not make any withdrawals from the Manufacturers Trust Company account to pay additional salaries. Monroe never saw his father make the cash payments which he claimed to have made to employees, approximating $800 per month over the three year period. The books of the corporation did not reflect any additional payments for labor during the years 1938 to 1945, inclusive. The corporation paid a commission of $5,000 annually to at least one person for obtaining business during the years 1938 through 1942. These payments were not reflected on its books and were derived from funds on deposit in the two unrecorded bank accounts. No allowance was made by the respondent for

expenditures other than those found on the corporation books. A tax consultant was unable to find on the books any specific amounts paid out for salaries or wastepaper.

In failing to report certain sales, the corporation went through the regular process of issuing a charge for them but the proceeds when received were not included on the books of account. The usual sales voucher was given at the time the sales were made. Jacob told various persons that he opened the accounts with the Sterling National Bank and the Public National Bank because he was going to use the money deposited therein for purposes which he could not reveal. Jacob also declared that he was paying extra amounts to paper dealers but the records of the corporation do not reflect any such payments. No items drawn from the corporation's two bank accounts other than the Manufacturers Trust Company account were identified upon the corporation's books. Jacob never informed Monroe of the fact that all sales were not being included on the corporate books.

(R. 675)

The merchandise inventories of J. J. Dix, Inc. at December 31 were as follows:

1940	$29,045.86
1941	44,896.70
1942	23,416.50
1943	10,419.60
1944	20,867.00
1945	23,584.65

The corporation did not declare any dividends from 1938 through 1945.

About April 1945, Monroe first discovered that deposits and withdrawals from the Sterling National Bank and the Public National Bank were not on the corporation's books. At that time Jacob was spending considerable sums of money and Monroe asked his father for an accounting, which was refused. Considerable disagreement arose between the father and son and the firm's accountant concerning the failure to record gross sales and costs. Jacob refused to disclose what he did with the omitted funds. After his wife's death, Jacob Dix became the dominant person in the management of the firm and Monroe was subordinated to his father. Monroe learned from his mother prior to her death that his father had a weakness for gambling. Jacob went to Florida on vacations lasting several months in the wintertime and received the money for these trips from Monroe. Because of his domination of the corporation, no attempt was made by Monroe to curtail Jacob's expenditures. Personal checks of Jacob were drawn to hotels and gamblers in Florida. In 1944, $10,000 worth of traveler's checks were purchased by Jacob and a similar amount was purchased in 1945. Monroe purchased $10,000 worth of American Railway Express traveler's checks in

(R. 676)

1944. These purchases were made for Jacob's convenience in obtaining cash with funds derived from the unreported bank accounts. Monroe did not know how his father spent the money so obtained.

After Jacob's death, $25,500 in cash was found in a vault in the name of his stepdaughter. Monroe, a co-executor of his father's estate, was unaware of the existence of this money prior to his father's death.

The federal income tax returns of Jacob and Monroe for the years 1938 through 1945 do not disclose any of the

funds withdrawn from the Sterling National Bank and the Public National Bank in these years. It is agreed by the parties that any money drawn by Monroe and Jacob from these two accounts and not returned to or spent on behalf of the corporation were withheld from and are due to J. J. Dix, Inc.

Total deposits in Monroe's bank accounts in 1939 amounted to $30,552.92. The following deposits are identifiable:

Salary reported on return		$ 7,800.00
Proceeds of sale of securities reported on return		4,928.85
Jan. 27.	J. J. Dix Inc. Exchange	1,500.00
	J. J. Dix Inc. Exchange	1,500.00
Mar. 20.	H. Grieson Exchange	500.00
Apr. 8.	New Rochelle Trust Exchange	350.00
13.	H. Grieson Exchange	2,000.00
May 11.	H. Grieson Exchange	2,000.00
Sept. 15.	Loan—National City Bank	1,054.00
Dec. 9.	J. J. Dix, for car	1,200.00
21.	J. J. Dix, Inc.	500.00
		$23,332.85

In the years 1942 through 1945, Monroe Dix, as sales manager of the corporation, purchased gifts for suppliers and customers. Jacob also incurred entertainment expenses on behalf of the corporation during these years. Monroe traveled for the corporation during 1944 and 1945 to see contractors located near the east coast. The corporation

(R. 677)

reimbursed Monroe and Jacob for traveling and entertainment expenses of the corporation incurred during these

years. Corporate expenses for traveling, entertainment, gifts and similar purposes were $5,000 in 1942, $8,000 in 1943 and $11,000 in each 1944 and 1945.

The income tax returns of Monroe and Jacob and the income, declared value excess profits tax and excess profits tax returns of the corporation for the calendar years 1938 through 1942 were filed on or before March 15, 1943. The respondent determined the deficiencies against the petitioners on November 9, 1949. The petitioners, Monroe Dix and the Estate of Jacob J. Dix, by amended petitions, pleaded that the deficiencies determined as to the years 1938 through 1941 were barred by the statute of limitations. The Current Tax Payment Act of 1943 is pleaded as a discharge of the 1942 tax liability. Petitioner, J. J. Dix, Inc., pleaded the statute of limitations as a bar to the deficiencies determined for the years 1938 through 1942. Each of the taxpayers filed consents fixing the period of limitation upon assessment of income and profits tax and extending the period of assessment in each of the years 1943, 1944 and 1945 until June 30, 1950.

In June 1945, Monroe and Jacob together with their accountant sought tax advice regarding the returns for the years 1943, 1944 and 1945 because of the unreported receipts and disbursements. In August 1945, a letter was addressed to the respondent stating that there had been an understatement of gross income. The letter informed the respondent that the taxpayer was making a voluntary dis-

closure and requested a detailed investigation. The letter also declared that it appeared that additional income taxes were due the federal government. No examinations of the

petitioners' returns were pending at the time this letter was sent to the respondent.

The respondent, in determining the deficiencies did not allow any deductions for payments to wastepaper dealers, or for salaries or commissions that are not reflected on the books of account. The respondent increased annual sales of the corporation in the following amounts:

1938	$ 6,222.40
1939	13,614.90
1940	32,872.36
1941	37,789.82
1942	9,593.65
1943	30,588.30
1944	66,189.17

The respondent allocated one-third of the money drawn out of the Sterling National Bank and the Public National Bank accounts for the years 1938 through October 20, 1944 to Monroe, and two-thirds to Jacob. After that date, equal allocations were made. The petitioners' representatives co-operated with the respondent's investigators. Respondent determined fraud penalties as to Jacob, Monroe and the corporation.

No part of the deficiencies determined by the respondent against Monroe Dix for the years in question was due to fraud with intent to evade tax. Part of the deficiencies determined in each of the years in question against the estate of Jacob J. Dix was due to fraud with intent to evade tax. Part of the deficiencies determined in the years 1938 through 1944 against J. J. Dix, Inc. was due to fraud with intent to evade tax.

(R. 679)

Opinion

VAN FOSSAN, *Judge:* At the outset it should be noted that the respondent concedes that the period prescribed by the normal statute of limitations[1] has expired upon those determinations against which the petitioners have pleaded the statute of limitations. The respondent contends, however, that, excepting the corporation for 1945, all the petitioners were guilty of fraud during the years before us. To sustain the deficiencies otherwise barred by the statute of limitations, the respondent must prove fraud by clear and convincing evidence.

The initial question to be determined is whether the petitioner corporation realized additional net income in excess of the amounts reported by it during the years in question. It is agreed that receipts from sales in the amount of $196,870.60 were deposited in the Sterling National Bank and the Public National Bank during the years 1938 through 1944. These amounts were not recorded on the corporate books nor included in gross receipts for tax purposes. The petitioners contend, however, that some of the money so deposited was later withdrawn and deposited in the corporation's regular bank account and recorded as sales receipts on its books and tax returns.

During 1945 "exchange checks" drawn by Monroe Dix in the amounts of $26,244.05 and $3,135.45 were deposited by the corporation in its regular bank account and credited

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[1]SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(R. 680)

to sales. The funds originated in the Sterling National and Public National bank accounts, as did the funds used to purchase $34,000 worth of United States Treasury Bonds similarly credited to sales on the corporate books. This total of $63,379.50 was included in 1945 income of the corporation and reported as such. The respondents determined no unreported corporate sales for 1945. We do not know whether such sales proceeds were deposited in the unrecorded bank accounts in 1945, or in previous years. But since the respondent has not included unreported sales for 1945 in the determination of the deficiencies before us, the deficiencies for the prior years would be unaffected regardless of whether the amount of $63,379.50 represented sales' proceeds for 1945, or for prior years.

During the years 1939 through 1942, Jacob and Monroe Dix drew "exchange checks" aggregating $13,000 and $27,750, respectively, which were deposited by the corporation in its regular account. Although no direct evidence exists that these amounts were properly included in sales income during the years of receipt, we reach the above conclusion because the sums were not credited to special accounts but to cash sales during this period. Corporate bank accounts and accounting records balanced. Monroe did not receive back any of the money so deposited nor was any portion of it reflected in the net worth of Jacob and Monroe. The total of these checks, $40,750, must be considered to have been reported as sales income in the years when received in the regular corporate bank account. No contention is made that the corporation did not report the sales reflected on its accounting records. A reduction, in the amount of $40,750, must be made to the unreported sales determined by the respondent for the respective years in which the exchange checks were received.

(R. 681)

The parties agree that amounts aggregating $5,486.87 were paid from the Sterling National and Public National Bank accounts and represented allowable deductions from gross income during the years specified in the findings of fact. These amounts similarly reduce unreported corporate sales for the years in which they were paid for purposes of determining unreported corporate net income. Also included in the total of unreported sales was $5,200, the proceeds from the sale of a machine belonging to another corporation. This amount can be excluded from the unreported sales of the petitioner corporation in the year that the proceeds of this sale were deposited in the petitioner corporation's bank account. The parties agree that the proceeds were derived from the sale of a machine that did not belong to the corporation but the evidence does not disclose in which year the receipts were erroneously deposited in the petitioner's bank account. If the parties can agree upon the year of deposit on the Rule 50 computation, this amount will be excluded from unreported sales of that year.

The petitioners contend that amounts were expended by the corporation from the two unreported bank accounts for business purposes which should be subtracted as cost of goods sold or deducted as expenses[2] from the balance of

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[2]SEC. 23. DEDUCTIONS FROM GROSS INCOME.
In computing net income there shall be allowed as deductions:
(a) Expenses.—
(1) Trade or Business Expenses.—
(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodgings) while away from home in the pursuit of a trade or busi-

unreported sales in the determination of net income during the several years before us. It is urged that amounts were expended by Jacob Dix in making overceiling payments to wastepaper dealers in order to have such persons consign paper to paper board manufacturers for the benefit of J. J. Dix, Inc. It is estimated by the petitioner that $25,000 was used for this purpose. However, there is no evidence as to the actual payment of any money for this purpose. Monroe never saw his father make payments of this type. Although he gave his father considerable sums of money over the period when paper was in short supply, he did not know how his father spent these funds. The prevalent practice of making overceiling payments to wastepaper dealers was well known and it may be that Jacob Dix made such payments from funds originating in the unrecorded bank account. It is impossible to determine, however, except by mere guesswork, how much was spent for this purpose. Assumptions based upon the business transacted by J. J. Dix, Inc. and the Continental Paper Company do not provide a basis for estimating overceiling payments to wastepaper dealers. It is not known how much above the ceiling price was paid by Jacob nor what portion of the paper shipped to the corporation resulted from overceiling payments. Moreover, it is not known in what years such payments were made, even if the total could be estimated. The petitioners' estimate of $25,000 is not broken down into yearly figures which would be required to offset unreported sales of specific annual amounts

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ness; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

and to redetermine the tax on annual income. This contention must be denied for failure of proof.

The petitioners contend that a portion of the sum of $5,317.41 paid by Monroe Dix in 1943, 1944 and 1945 is

(R. 683)

deductible as wages to factory workers engaged in the production of the corporation's products. Monroe was reimbursed from the Public National Bank account for these salaries. Salaries paid to production workers qualify as segments of cost of goods sold. However, the amount paid by Monroe to workers engaged in production, rather than those engaged in office work, is not known and no basis exists for making a reasonable estimation. Monroe was in charge of some office workers and no evidence of record demonstrates what portion of the amounts spent was paid to workers engaged in production. For this reason, deduction of some portion of the amounts paid by Monroe cannot be allowed.

The petitioners urge that Jacob Dix paid $28,800 in overceiling salaries during 1943, 1944 and 1945 to employees at an approximate rate of $800 per month and seek to deduct such amount from unreported sales. There is no direct evidence of such payments. The only evidence presented is testimony as to what Jacob said he paid and a note of Jacob's stating that he made such payments. In view of the record as to Jacob's conduct in the corporation's business affairs, we can give little credence to such secondhand evidence. Monroe had no knowledge concerning such payments other than what his father told him. No other evidence of record supports the contention made. The petitioners must bear the burden of proving that such amounts were paid by Jacob to persons engaged in production and

that the money paid was derived directly or indirectly from the bank accounts in which the unreported sales were deposited. This burden has not been sustained. The petitioners have not proven that Jacob made annual payments in any amount to factory workers. The deduction of amounts allegedly paid by Jacob over the years to factory workers must be denied for lack of proof.

(R. 684)

The petitioners seek deduction for commissions paid. The evidence discloses that commissions were paid by Jacob to at least one person for obtaining business during the years 1938 to 1942. The payments were made in cash derived from the unreported bank accounts. The evidence does not establish how much was paid yearly but it provides a basis for the estimation under the rule of *Cohan* v. *Commissioner*, 39 F. 2d 540, that $5,000 was paid in each year from 1938 to 1942. Deductions of $5,000 annually under the provisions of section 23 (a) of the Internal Revenue Code as business expenses will be made in each of these years from the unreported sales of each year in order properly to reflect annual net income of the corporation.

We conclude, in summary, that the unreported sales over the period 1938 through 1944 aggregating $196,870.60 must be reduced in the amount of $40,750 which was reported as income in the years received, as set forth in the findings of fact. A further reduction must be made in determining annual corporate net income over these years in the amount of $5,486.87 representing proper deductions in the years specified in the findings of fact. A deduction of $5,000 must also be taken in each of the years from 1938 to 1942 for commissions paid and $5,200, the proceeds of the sale of a machine, is to be eliminated from unreported sales income in the year of its receipt.

The petitioners seek to support further reductions of corporate income resulting from unreported sales during these years by the fact that the petitioner corporation's percentage of gross profits was higher than the industry average. It is sufficient to note that while the corporation may have expended considerable sums paying overceiling prices and wages, the evidence does not substantiate the disbursements of such amounts in the years before us.

(R. 685)

The final contention made with respect to the unreported sales is that those amounts not returned to the corporation or expended on its behalf were misappropriated by Jacob Dix and deduction therefor is sought under section 23 (f), I. R. C.[3] as a loss sustained as a result of the misappropriation of funds. The evidence gives good reason to believe that Jacob improperly took corporate funds and spent the money for his own benefit. The evidence, however, does not disclose how much Jacob improperly appropriated from funds deposited in the corporate accounts with the Sterling National and Public National Banks. The amounts returned to the corporation's regular bank account, the amounts expended for overceiling payments to wastepaper dealers, commissions and the amounts spent for other corporate purposes were not misappropriated. The amounts expended for overceiling payments to wastepaper dealers have not been established and we do not know how much

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[3] SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) Losses by Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

Jacob misappropriated. Nor do we know the years in which Jacob misappropriated corporate funds, nor the amounts taken by him annually for his own purposes. Even if deduction of the entire amount might be allowed in 1945, the year of discovery of the theft, in accordance with *Gwinn Bros. & Co.*, 7 T. C. 320, the total amount misappropriated is unknown. No basis exists in the evidence to make an estimation of the amount of money improperly taken by Jacob. For this reason, the deductions for any losses sustained as a result of misappropriated funds must be denied to the corporation.

(R. 686)

The second issue relates to traveling, selling and entertainment expenses of the petitioner corporation for the years 1942 and 1945. The corporation expended various sums in reimbursement of Jacob and Monroe for traveling and entertainment expenses on behalf of the corporation during 1942, 1943, 1944 and 1945. In the latter two years, Monroe was required to travel to contact suppliers of the corporation during the period of the paper shortage. The corporation also incurred expenses in the years 1942 through 1945 for gifts, presents and other items purchased for good will purposes.

The respondent admits that increased expenses over the amounts determined have been established by the petitioners. We have found that amounts expended by the petitioner corporation in traveling and entertainment expenses aggregated $5,000 in 1942, $8,000 in 1943, and $11,000 in each 1944 and 1945. These amounts are properly deductible by the corporation in these years.

The final issue relating to the petitioner corporation, excepting the fraud issue, is whether the respondent erred

in making inventory adjustments in 1941, 1942 and 1943 to equalize the corporation's gross profit during the years 1941 through 1945. On brief respondent, in effect, admits the corporation's contentions as to the inventories. The record supports the corporation on this item and consequently all of respondent's adjustments growing out of inventory adjustments for the years 1941 through 1945 are eliminated.

The principal issue presented with respect to the deficiencies determined against Monroe Dix is whether that petitioner realized unreported net income in the amount of $81,242.11 during the years in question. This amount is determined by the respondent as one-third of the unreported sales of the petitioner corporation up to October 20, 1944

(R. 687)

and one-half thereafter because Monroe Dix owned one-third and one-half, respectively, of the corporation's stock during these periods. It is noted that sizable portions of the total unreported sales have been eliminated from corporate net income because specific amounts originating in the unreported bank accounts were spent for corporate purposes. Moreover, the respondent's determination that Monroe received one-third and one-half of the unreported sales during the period before us is erroneous because the evidence does not disclose that Monroe received any amount from the unreported sales proceeds as income. The evidence reveals that Monroe drew checks on the unreported bank accounts and either turned the money over to his father, spent it on behalf of the corporation or deposited it by exchange check in the regular corporate bank account. Monroe did not keep for himself any amount withdrawn from the Sterling National and Public National Bank ac-

counts. No income derived from this source is reflected in his net worth. Although he may have been lax, as a corporate officer, in failing to discover his father's defalcations until April 1945, the evidence does not support the contention advanced by respondent. For this reason, he cannot be deemed to have failed to report any portion of the $81,242.11 determined by the respondent. A second issue relating to the deficiencies determined against Monroe Dix is whether the respondent erred in adding $10,100 in unidentified bank deposits to 1939 net income. The parties agree that deposits to Monroe's bank account in 1939 aggregated $30,552.92, of which $23,332.85 is identifiable. Included within the identified portion are salary payments and the proceeds of a sale of securities which were reported on his return. The balance of the deposits, except possibly for one item, were not items of income. The unidentified bal-

(R. 688)

ance of $7,220.07 and the $500 paid by J. J. Dix, Inc. in December 1939 may have represented deposits of income items. However, the respondent agrees that the statute of limitations bars any deficiency for this year unless fraud is proved.[4] The evidence does not establish fraud by Monroe as to the 1939 income.[5] Lacking fraud, the defi-

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[4]SEC. 276. SAME—EXCEPTIONS.

(a) False Return or No Return.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * *

[5]SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) Fraud.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d)(2).

ciency determined against him for 1939 is barred. The remaining deficiencies determined against Monroe have been held to be in error and consequently there can be no fraud penalties.

The respondent determined that Jacob Dix failed to report $121,834.89 as income during the years 1938 through 1945. This sum, it is said, represents the balance of unreported corporate sales not included in the income of Monroe Dix. Of the total unreported sales of $196,870.60, we have found that $40,750 was returned to the corporation by exchange checks and properly included in income. The sum of $5,200 belonged to another corporation and $5,486.87 was expended from the fund of unreported sales for deductible purposes. Of the total amount of $63,379.50 was returned to the corporation in 1945 and reported as income in that year. Monroe was reimbursed from the Public National Bank account in the amount of $5,317.41 for overceiling salaries paid. A total of $20,000 was paid from the

(R. 689)

unreported bank accounts for commissions during the years 1938 to 1942. These amounts, totaling $140,133.78, could not have been received as income by Jacob Dix. The balance of $56,736.82 is all that Jacob could have received as income. The corporation also spent some portion of the unreported sales fund in overceiling payments to wastepaper dealers, but this amount cannot be ascertained from the evidence before us.

The amounts spent annually by Jacob for his own purposes is unknown and deductions have been denied to the corporate petitioner because of this failure of proof. Although Jacob's net worth did not reflect any such misappropriations, he spent large amounts on vacations and

gambling which might not be reflected in a determination of his net worth. The sum of $25,500, which could not be identified as to source, was discovered at his death. The respondent has determined that all of the unreported sales, except the amounts attributable as income to Monroe, should have been reported by Jacob as income in the years the sales proceeds were received. We have determined, by eliminating specific sums from the unreported corporate sales of the individual years, that the total amount that could have been received as income by Jacob during the years 1938 through 1945 is $56,736.82. The estate of Jacob J. Dix, as the petitioner, must bear the burden of proof in combatting the deficiency. It has not established that the respondent erred in his determination that Jacob appropriated this amount for his own purposes during the years in question. As a result, we conclude that the respondent must be sustained to the extent of $56,736.82 being included as income of Jacob Dix during these years.

The parties agree that any amounts taken by Jacob which were not returned to or expended on behalf of the corporation, belong to and are due to that corporation. Jacob ac-

(R. 690)

quired these funds by withdrawing money from corporate accounts for his own purposes and by misappropriating funds given to him for business purposes by Monroe. Until 1945, Monroe was unaware of the true situation and he did not realize that all corporate sales were not being reported. Monroe, dominated by his father and deceived as to Jacob's purposes in obtaining corporate funds, was unable to prevent the misuse of corporate bank accounts. Jacob, utilizing his dominant position to his own personal advantage, deceived his son and the corporation's accountant while im-

properly acquiring corporate funds for his own benefit. We do not believe *Commissioner* v. *Wilcox,* 327 U. S. 404, cited by the petitioners, controls the factual situation presented here so as to preclude placing the misappropriated fund in Jacob's income. *Rutkin* v. *United States,* 343 U. S. 130, limits the *Wilcox* decision to its facts. The facts here are distinguishable and we have held that the sum of $56,736.82 must be considered as income of Jacob Dix during the years in question on the basis of the *Rutkin* decision and this Court's decisions in *Henry C. Boucher,* 18 T. C. 710, and *W. L. Kann,* 18 T. C. 1032.

Jacob Dix knew that he had received large amounts of funds from the corporation and from Monroe which he failed to report as income, although he used the money for his own purposes. No excuse or explanation is presented. As above noted, the evidence that Jacob acquired the funds by fraud practiced upon Monroe and by his domination of his son. There can be no doubt Jacob wished to continue his peculations and for this reason omitted the corporate sums acquired for his own purposes from his tax returns. The respondent has sustained the burden of proving that Jacob fraudulently omitted from income the amounts appropriated by him for his own purposes during all the years before us. Since Jacob was guilty of fraud as to all the years, the

(R. 691)

deficiencies determined against him are not barred by the statute of limitations.

The petitioner corporation's failure to report all of its gross income and to pay taxes upon its proper net income was due to the fraud of its president, Jacob Dix. Jacob, as president of the corporation, without the knowledge or assistance of Monroe, had kept deposits of sales proceeds

from being included on the corporate records or reported for tax purposes. Monroe was of the mistaken opinion that all corporate sales were reflected on the tax returns and did not discover his error until 1945. He then brought the matter to the attention of the respondent's agents. As noted above, the failure of the corporation to file proper returns is not due to any fraud on the part of Monroe. But Jacob, as president of the corporation, was clearly guilty of fraud in filing corporate returns. The wilful failure to report corporate income derived from sales proceeds known to have been received and deposited in corporate bank accounts leaves no conclusion to be drawn other than fraud. No reason has been suggested for the failure to report sales receipts deposited in these accounts other than that the corporation's principal officer wished to appropriate corporate funds for his own purposes without paying taxes. We hold that the corporation, acting through Jacob Dix as its agent, must be held responsible for the fraud of its president in filing false corporate returns. *Summerill Tubing Co.*, 36 B. T. A. 347; *Saven Corporation*, 45 B. T. A. 343. The additions to the tax due to fraud by the corporation are sustained as to the years 1938 through 1944. None of the deficiencies determined against the corporation for any of the years are barred by the statute of limitations.

Decisions will be entered under Rule 50.

Entered May 20, 1953.

(R. 692)

THE TAX COURT OF THE UNITED STATES

WASHINGTON

J. J. DIX, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 26251

Decision

Pursuant to the Court's Memorandum Findings of Fact and Opinion entered May 20, 1953, the parties herein having filed an agreed computation of tax on October 19, 1953, it is

ORDERED and DECIDED: That there are deficiencies and penalties in taxes due from this petitioner as follows:

	Income Tax		Declared Value Excess-Profits Tax	
Year	Deficiency	50% Penalty	Deficiency	50% Penalty
1938	$ 762.27	$ 381.14	$ None	$ None
1939	1,762.19	1,021.26	1,440.15	720.08
1940	None	None	None	None
1941	3,032.20	1,945.85	875.29	437.65
1942	761.15	232.33	—	—
1943	2,568.18	1,284.09	294.42	147.21
1944	2,897.77	1,448.89	—	—
1945	2,586.48	None	—	—

EXCESS-PROFITS TAX

Year	Deficiency	50% Penalty
1941	$ None	$ None
1942		None
1943	2,461.27	1,230.64
1944	19,146.16	9,573.08

ERNEST H. VAN FOSSAN,
Judge

Entered: Oct. 20, 1953

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 23-24—October Term 1954

Argued April 21, 1955 Decided June 2, 1955

J. J. DIX, INC., *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

ESTATE OF JACOB J. DIX, Deceased, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Docket Nos. 22989-90

Before: FRANK, MEDINA and HINCKS, Circuit Judges.

Appeal from decisions of the Tax Court of the United States, Judge Van Fossan. Affirmed as to *J. J. Dix, Inc.* v. *Commissioner;* reversed as to *Estate of Jacob J. Dix* v. *Commissioner.*

BERNARD WEISS for petitioners,

H. BRIAN HOLLAND, ELLIS N. SLACK, A. F. PRESCOTT and S. DEE HANSON, for respondent.

FRANK, Circuit Judge:

The facts and rulings of the Tax Court are set forth in the opinion of Judge Van Fossan, reported unofficially in *12* T. C. M. *536.*

I. The Corporate Taxpayers' Appeal

The Tax Court found that the corporate taxpayer, during the years 1938 through 1944, realized net taxable income amounting to $62,054.23 in excess of the amounts recorded on its books and reported on its tax returns filed for those years. It is undisputed that the corporation during the above period realized from its sales the sum of $196,870.60 which was secretly deposited in two banks, and that the amounts so received were not recorded on its books or included in gross receipts on its tax returns. The Commissioner, in determining the deficiencies, increased the corporation's annual sales income, by that amount, without allowing a deduction, because it was not recorded on the corporation's books as required by Sections 41 and 54(a) of the Internal Revenue Code of 1939.

The Tax Court found, and taxpayer conceded, that the corporate gross income had been understated in the total sum of $196,870.60. It found further, however, that the corporation was entitled to deductions aggregating $134,-816.37, and therefore that its taxable income had been fraudulently understated and unreported in the remaining sum of $62,054.23, redetermining the deficiencies and fraud penalties accordingly.

Taxpayer contends that the corporation is entitled, in addition to the deductions allowed by the Tax Court, to further deductions exceeding $62,000 as follows: (a) overceiling payments of approximately $25,000 purportedly made in behalf of the corporation by its president, Jacob Dix, to blackmarket wastepaper dealers; (b) overceiling wages totalling about $28,800 allegedly paid in cash by Jacob to the corporation's production employees; (c) approximately $3,000 paid by Jacob as commissions over and above the total amount thereof ($20,000) allowed by the Tax Court; and (d) overceiling extra salaries of

$5,317.41 allegedly paid to the corporation's office and factory employees by vice-president Monroe Dix. The Tax Court, for failure of proof, denied the deduction of these additional items, and the taxpayers assert that this is error. We submit that there is no merit in these contentions.

We think the Tax Court's decision correct. Judge Van Fossan's opinion, analyzing in detail the taxpayer's evidence, shows that taxpayer did not discharge its proof-burden. And its proof left the matter so vague and conjectural as to render it impossible, as the Tax Court held, to apply the doctrine of *Cohan* v. *Commissioner*, 39 F. (2d) 540 (C. A. 2).

Taxpayer contends, alternatively, that the sum of $56,736.82, out of the total unreported sales proceeds, represents corporate funds misappropriated by Jacob, and therefore the corporation is entitled to deduction of this sum as a loss sustained during the years 1938 through 1945, under Section 23(f) of the 1939 Code. The Tax Court found, we think, correctly that the taxpayer did not show the amount of the misappropriation or the years in which misappropriations occurred. It said: "No basis exists in the evidence to make an estimation of the amount of money improperly taken by Jacob. For this reason, the deductions for any losses sustained as a result of misappropriated funds must be denied the corporation." Moreover, there was no proof that the corporation will not recover from Jacob's estate whatever amounts he did misappropriate.

The evidence, and entirely reasonable inferences drawn from the evidence, demonstrate that the Commissioner discharged the burden of establishing fraud by clear and convincing evidence of wilful intent to evade taxation, and that therefore the imposition of 50% fraud penalties was justified. Because of the fraud, the statute of limitations was inoperative.

The adjustment of income for the several taxable years caused over-assessments of excess profits for other years. Taxpayer contends that it is entitled, as an equitable setoff against deficiencies, to refunds of such over-assessments, although such refunds are barred by the statute of limitations. We do not agree. See *Babcock & Wilcox Company* v. *Pedrick*, 212 F. (2d) 645, 648-649 (C. A. 2).

II. The Estate of Jacob J. Dix

The Tax Court held that Jacob Dix realized taxable income of $56,736.82, i.e., the amount of corporate funds he misappropriated. We think this was error. Jacob withdrew those moneys from the corporate bank accounts without the consent, coerced or otherwise, of the company. That he was the president did not amount to corporate consent. We have here a simple case of embezzlement, not one involving a receipt under any color of right. Accordingly, we think *Commissioner* v. *Wilcox*, 327 U. S. 404, governs, and that *Rutkin* v. *United States*, 343 U. S. 130 does not apply. We do not believe that Rutkin completely obliterated Wilcox. "Since the Court in *Commissioner of Internal Revenue* v. *Wilcox* flatly held that embezzled funds were not taxable income to the embezzler, and in the *Rutkin* case has unequivocally held that funds were taxable income to the extortionist, the line of demarcation lies between those rather closely related factual situations and must be determined by the facts in the individual case." *Marienfeld* v. *United States*, 214 F. (2d) 632, 637 (C. A. 8). In the instant case, the facts are close to those of Wilcox and lack the distinguishing features found in *United States* v. *Bruswitz*, 219 F. (2d) 59 (C. A. 2), and cases there cited. See also the dissent of Judge Kalodner in *Kann* v. *Commissioner*, 210 F. (2d) 247, 253 (C. A. 3).

Affirmed as to J. J. Dix, Inc.; reversed as to Estate of Jacob J. Dix

UNITED STATES COURT OF APPEALS

Second Circuit

At a Stated Term of the United States Court of Appeals in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 2nd day of June, One thousand nine hundred and fifty-five.

Present:

Hon. Jerome N. Frank,

Hon. Harold R. Medina,

Hon. Carroll C. Hincks,

Circuit Judges

J. J. Dix, Inc.,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

/s/ A. Daniel Fusaro
Clerk

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

J. J. DIX, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JUDGMENT

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

FILED JUNE 2, 1955

A. DANIEL FUSARO, CLERK

APPENDIX B

Statutes & Regulations

U. S. Internal Revenue Code of 1939 Enacted Feb. 10, 1939—Ch. 2, 53 Stat. 1-504.

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses:

(1) Trade or business expenses:

(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * * *

(f) Losses by Corporations:

In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

Sec. 272. Procedure in General

(a)(1) Petition to The Tax Court of the United States:

If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the Tax Court of the United States for a redetermination of the deficiency.

Sec. 275. Period of Limitation upon Assessment and Collection.

Except as provided in Section 276—

(a) General Rule. The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Regulations 111:

Sec. 29-22(a)-5 Gross Income from Business.

In the case of a manufacturing, merchandising, or mining business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operation or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses, or losses or for items not ordinarily used in computing the cost of goods sold.

344 U. S. 167

APPENDIX C

ALLISON v. UNITED STATES

UNITED STATES v. STEVENSON-CHISLETT, INC.

Nos. 79, 80

Argued, Nov. 12, 1952

Decided Dec. 8, 1952

Separate actions by two taxpayers for refund of income taxes on ground that embezzlements discovered after filing of returns were deductible as losses. The United States District Court for the Western District of Pennsylvania, 97 F. Supp. 959, entered judgment in one case adverse to taxpayer, and taxpayer appealed. The United States District Court for the Western District of Pennsylvania, 98 F. Supp. 252, entered judgment in other case adverse to Government, and it appealed. The Court of Appeals certified the question of deductibility in both cases. The Supreme Court, Mr. Justice Black, held that under provision of Internal Revenue Code authorizing deduction from gross income for losses sustained during the taxable year, when embezzlements by trusted employees were not discovered for several years, sums embezzled might be taken as losses in year in which embezzlements were discovered.

Judgment in the first case reversed, and judgment in second case affirmed.

Mr. Justice Douglas and Mr. Justice Burton dissented.

1. INTERNAL REVENUE—663

The term "embezzlement" is not synonymous with the term "loss" as used in provision of Internal Revenue Code

authorizing deductions from gross income for losses sustained during the taxable year, since, although the theft by embezzlement occurs in a particular year, loss in that year is not inevitable in that the property stolen may be recovered. 26 U. S. C. A. § 23 (e, f).

2. INTERNAL REVENUE—663

Under provision of Internal Revenue Code authorizing deductions from gross income for losses sustained during the taxable year, the question of whether and when a deductible loss results from an embezzlement is a factual question, depending for its solution on the surrounding circumstances, and it is not an inevitable conclusion that the loss occurred in same year as the embezzlement. 26 U. S. C. A. § 23 (e, f).

3. INTERNAL REVENUE—663

Under provision of Internal Revenue Code authorizing deductions from gross income for losses sustained during the taxable year, when embezzlement of funds by trusted employee of taxpayer was not discovered for several years, taxpayer was entitled to take the amount embezzled as a loss in the year in which the embezzlement was discovered. 26 U. S. C. A. § 23 (e, f).

Mr. Karl E. Weise, Pittsburgh, Pa., for Allison.

Mr. David B. Buerger, Pittsburgh, Pa., for Stevenson-Chislett, Inc.

Mr. Hilbert P. Zarky, Washington, D. C., for the United States.

Mr. Justice Black delivered the opinion of the Court.

The questions in these two income tax cases are so much alike that they can be treated in one opinion. Both taxpayers had moneys embezzled by trusted agents and

employees. As usual, the defalcations had been going on for many years before they were discovered. On discovery, efforts were made immediately to identify the takers and fix the dates and amounts of the thefts. In the *Alison* case, No. 79, the books revealed the thief and the precise amounts taken each year from 1931 to 1940. In No. 80, Stevenson-Chislett, Inc., the cover-up had been so successful that painstaking investigation failed to reveal who took the funds or the time when the unascertained person or persons took them. Each taxpayer claimed a tax reduction for the year the losses were discovered and their amounts ascertained. The Government objected, claiming that the deduction should have been taken in each of the prior years during which the moneys were being surreptitiously taken. In the *Stevenson-Chislett* case, the District Court held that the uncertain circumstances of the embezzlement entitled the taxpayer to take its losses the year the loss was discovered and the amount ascertained. 98 F. Supp. 252. The District Judge decided the other way in the *Alison* case and denied her declarations. D. C. 97 F. Supp. 959. His holding, however, was not in accord with his own views, but was compelled, he thought, by the Third Circuit's decision in *First National Bank of Sharon, Pa.* v. *Heiner,* 66 F. 2d 925. The Court of Appeals for the Third Circuit certified to us the question of deductibility in both cases. Pursuant to 28 U. S. C. § 1254(3), 28 U. S. C. A. § 1254(3), we ordered the complete records sent up so that we might decide the entire matters in controversy.

Internal Revenue Code, § 23(e) and (f), 26 U. S. C. A. § 23 (e, f), authorize deductions for "* * * losses sustained during the taxable year * * *." The Government reads this section as requiring a taxpayer to take a deduction for loss from embezzlement in the year in which the

theft occurs, even though inability to discover in time might completely deprive the taxpayer of the benefit of this statutory deduction. Only at the time the money is stolen, so it is argued, is a loss "sustained." But Treasury practice itself belies this rigid construction. For more than thirty years the Regulations have provided that "A loss from theft or embezzlement occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained." 26 CFR § 29.43-2. (Emphasis supplied) Information contained in a letter from the Commissioner attached as an appendix to the Government's brief cites many instances in which the Treasury has allowed deductions for embezzlement losses in years subsequent to those in which the thefts occurred. Apparently the Department has felt constrained to do this in order to prevent hardships and injustice. These have been departures from the "ordinary" rule of attributing embezzlement losses to the year of theft.

(1) This Treasury practice evidently stems at least in part from the special nature of the crime of embezzlement. Its essence is secrecy. Taxpayers are usually well aware of all the circumstances of financial losses for which tax deductions are allowed. Not so when a trusted adviser or employee steals. For years his crime may be known only to himself. He may take money planning to return it and he may return it before there is discovery. Furthermore, the terms embezzlement and loss are not synonymous. The theft occurs, but whether there is a loss may remain uncertain. One whose funds have been embezzled may pursue the wrongdoer and recover his property wholly or in part. See *Commissioner of Internal Revenue* v. *Wilcox*, 327 U. S. 404, 66 S. Ct. 546, 90 L. Ed. 752. Events in the *Alison* case show the practical value of this right of re-

covery. A substantial portion of the embezzled funds was recovered in 1941, ten years after the first embezzlement occurred. This recovery alone is ample refutation of the view that a loss is inevitably "sustained" at the very time an embezzlement is committed.

(2) Whether and when a deductible loss results from an embezzlement is a factual question, a practical one to be decided according to surrounding circumstances. See *Boehm* v. *Commissioner,* 326 U. S. 287, 66 S. Ct. 120, 90 L. Ed. 78. An inflexible rule is not needed; the statute does not compel it. For years the Treasury has administered the tax law under regulations saying that deductions shall "ordinarily" be taken in the year of embezzlement. Ordinarily does not mean always.

(3) We hold that the special factual circumstances found by the District Courts in both these cases justify deductions under I. R. C. § 23(e) and (f) and the long-standing Treasury Regulations applicable to embezzlement losses. See *Boston Consolidated Gas Co.* v. *Commissioner,* 1 Cir., 128 F. 2d 473; *Gwinn Bros. & Co.,* v. *Commissioner,* 7 T. C. 320. Accordingly, the judgment in No. 79 is reversed and the judgment in No. 80 is affirmed.

It is so ordered.

Judgment in No. 79 reversed and Judgment in No. 80 affirmed.

Mr. Justice Douglas and Mr. Justice Burton dissent.

APPENDIX D

COHAN v. COMMISSIONER OF INTERNAL REVENUE

39 F. (2d) 540, 543, 544.

* * * * *

(6, 7) In the production of his plays Cohan was obliged to be free-handed in entertaining actors, employees, and, as he naively adds, dramatic critics. He had also to travel much, at times with his attorney. These expenses amounted to substanial sums, but he kept no account and probably could not have done so. At the trial before the Board he estimated that he had spent eleven thousand dollars in this fashion during the first six months of 1921, twenty-two thousand dollars, between July 1st, 1921 and June 30th, 1922, and as much for his following fiscal year, fifty-five thousand dollars in all. The Board refused to allow him any part of this, on the ground that it was impossible to tell how much he had in fact spent, in the absence of any items or details. The question is how far this refusal is justified, in view of the finding that he had spent much and that the sums were allowable expenses. Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent. True, we do not know how many trips Cohan made, or how large his entertainments were; yet there was obviously some basis for computation, if necessary by drawing upon the Board's personal estimates of the minimum of such expenses. The amount may be trivial and unsatisfactory, but

there was basis for some allowance, and it was wrong to refuse any, even though it were the traveling expenses of a single trip. It is not fatal that the result will inevitably be speculative; many important decisions must be such. We think that the Board was in error as to this and must reconsider the evidence.

* * * * *

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 321

J. J. DIX, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 9–38) are not officially reported. The opinion of the Court of Appeals (Pet. 42–45) is reported in 223 F. 2d 436.[1]

[1] This case was consolidated for hearing and decision with the companion case of *Estate of Jacob J. Dix* v. *Commissioner* in both courts below (R. 3, 7, 9–38; Pet. 42–45), the issue involved in the latter having been decided in favor of the Commissioner by the Tax Court (R. 35–37), and reversed by the court below (Pet. 45). The Commissioner's petition for a writ of certiorari to the Court of Appeals for the Second Circuit therein was filed in this Court on August 30, 1955 (October Term, 1955, No. 363).

The record citations herein refer to the separate appendix

JURISDICTION

The judgment of the Court of Appeals was entered on June 2, 1955 (Pet. 46–47). The petition for a writ of certiorari was filed on August 13, 1955. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether the taxpayer corporation was properly held liable for the statutory addition to tax which is imposed where part of the deficiency is due to fraud with intent to evade tax under circumstances where its president and dominant officer prevented a large amount of its sales receipts from being recorded on its books or reported on its tax returns and deposited such receipts in secret bank accounts.

2. Whether the courts below were correct in concluding that the taxpayer was not entitled to additional deductions where the evidence was insufficient to substantiate the existence of alleged expenditures for black market purchases and illegal wage payments.

3. Whether the courts below were correct in concluding that the taxpayer had not sustained a deductible loss on account of misappropriations

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(record on review) filed by both taxpayers in these cases, together with their joint brief in the court below.

The dissenting opinion of Judge Hincks in the Court of Appeals is not printed with the opinion of that court in Appendix A to taxpayer's petition for certiorari.

of corporate funds, there being no proof that it would not be made whole if it should pursue its rights against the estate of the wrongdoer.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade

or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner,

with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(c) *Omission from Gross Income.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

* * * * *

(26 U. S. C. 1952 ed., Sec. 275.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such

tax may be begun without assessment, at any time.

* * * * *

(26 U. S. C. 1952 ed., Sec. 276.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d) (2).

(26 U. S. C. 1952 ed., Sec. 293.)

SEC. 1112. BURDEN OF PROOF IN FRAUD CASES.

In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner.

(26 U. S. C. 1952 ed., Sec. 1112.)

The corresponding sections of the Revenue Act of 1938, c. 289, 52 Stat. 447, are substantially the same as the above-quoted sections of the Internal Revenue Code of 1939.

STATEMENT

The pertinent facts as found by the Tax Court (R. 12–24), based on those stipulated by the

parties (R. 12) and upon the evidence (including exhibits) adduced at the hearing in the Tax Court, may be summarized as follows:

J. J. Dix, Inc. (hereafter referred to as the taxpayer or corporation), is a New York family-corporation which was engaged in the manufacture of paper boxes during the eight taxable years (1938–1945) involved here. Decedent Jacob J. Dix (herein called decedent) was the president and treasurer and at all times controlled the affairs of the corporation. His son Monroe L. Dix (hereafter called Monroe) was vice-president and a director of the corporation. The corporation's stock was owned by Monroe and two other children of the decedent. Although the decedent owned none of the corporate stock directly, he had a life estate in a trust owning one-third and later one-fourth of the corporation's outstanding stock, under which he was entitled to the dividends during his life. (R. 12–14.)

During the taxable years 1938 through 1945, the taxpayer realized taxable net income of more than $62,000 in excess of the amounts recorded on its books of account and reported on its tax returns filed for those years. This came about in the following manner:

The corporation's regular business bank account was maintained with the Manufacturers Trust Company. In 1938, the decedent opened a separate bank account in the name of the corpora-

tion with the Sterling National Bank and Trust Company. This account was closed in 1942. Thereafter, he opened another account in the name of the corporation with the Public National Bank in 1943. This account was closed in 1945. Deposits of corporate funds were secretly made by the decedent in the latter two bank accounts in the total sum of $196,870.60 during the years 1938 through 1944 so that the Manufacturers Trust Company, the corporation's regular banker, would not know that another bank account existed. None of these secret deposits were ever reflected on the corporation's books or reported on its tax returns for any of those years. All of the deposits made by the decedent in these secret bank accounts represented proceeds of merchandise manufactured and sold by the corporation in the regular course of its business. (R. 14, 15, 20.)

All checks drawn on these secret bank accounts were signed by and a substantial number were drawn to the order of the decedent and/or his son Monroe, and many were drawn to cash. The decedent drew numerous checks on the corporation's unrecorded account at the Sterling National Bank and deposited the funds in his individual bank account at the Bronx County Trust Company. Monroe, who drew checks from time to time on the corporation's regular business account, also drew checks on the secret account in the Sterling National Bank as well as on other banks, and turned the funds over to the decedent.

(R. 14–15.) Monroe had no knowledge of how the decedent spent this money.

During the years 1943–1945 the supply of paper board, necessary for the taxpayers' manufacture of paper boxes, was very limited, since many paper board mills were not operating at capacity because of the shortage of waste paper, the supply of which was controlled by waste paper dealers. It was common practice, in the paper box industry during those three years when supplies were inadequate (but only during that period), to have waste paper dealers deliver waste paper to paper board mills which would then allocate the supply of paper board to various paper box manufacturers. Extra cash over the prevailing ceiling prices was paid to black market dealers to induce them to deliver waste paper to the paper board mills. Such dealers delivered waste paper to the mills for the credit of the taxpayer. (R. 17.)

The Continental Paper Company (hereafter called Continental), for example, a manufacturer of paper board, which supplied to the taxpayer 25% to 35% of its paper board requirements, received 600 to 700 tons, 447 tons, and an undisclosed small quantity of waste paper in 1943, 1944, and 1945, respectively, from waste paper dealers for the credit of the taxpayer. During those same years it sold 613, 860, and 367 tons of paper board, respectively, to the taxpayer which

had been allocated to it by waste paper dealers who had sent the scrap paper therefor to Continental. Although Continental itself refused to buy at black market prices and paid only the legal ceiling prices, it was common knowledge in the trade that many of its customers were paying over-ceiling prices to waste paper dealers for paper stock; and Continental felt obligated to deliver the paper board manufactured therefrom, less shrinkage and quantities allocated to the federal government, to its customers as designated by the shippers. Monroe never saw his father pay any paper dealers amounts in excess of ceiling prices. (R. 17–18.)

During the same three years (1943–1945), the taxpayer employed, variously, 80 to 130 persons, four or five of whom were office employees under Monroe's supervision, the other being factory production workers. During those years Monroe paid out of his personal checking account additional salaries totalling $5,317.41 to certain employees of the taxpayer, and was reimbursed therefor by checks drawn on the taxpayer's secret account with the Public National Bank. These amounts paid to the taxpayer's employees by Monroe were never approved by the Wage Stabilization Board. Monroe never made any withdrawals from the taxpayer's regular business bank account for the payment of additional salaries. (R. 19.)

Monroe never saw his father make any over-ceiling cash payments which the father said that he had made to the taxpayer's factory workers in sums approximating $800 a month, aggregating about $28,800, over the above-mentioned three-year period, nor did the taxpayer's books reflect any such additional payments for labor during the eight-year period 1938–1945. The taxpayer's tax consultant was unable to find recorded on the corporate books any specific amounts paid out for salaries or waste paper. No allowances were made by the Commissioner to the taxpayer for deductions for purported payments to black market waste paper dealers, over-ceiling salaries and wages, etc., or any unproved expenditures other than those reflected and found on the corporation's books of account. (R. 19–20, 24.)

The taxpayer, in failing to report certain sales, went through the regular process of issuing the usual sales vouchers and charges therefor at the time the sales were made, but when the proceeds of the sales were received they were not recorded on its books. The decedent had told various persons that he had opened the taxpayer's two secret bank accounts because he was going to use the deposits for purposes which he could not reveal. He also declared that he was paying extra amounts of money to waste paper dealers, but, as pointed out, the records of the corporation failed to reflect any such payments. No items drawn from the taxpayer's secret bank accounts

were identified on the corporation's books. The decedent never informed Monroe of the fact that all the corporate sales were not being recorded on the corporation's books. (R. 20.)

Sometime in April, 1945, Monroe first discovered that the deposits in and the withdrawals from the two secret bank accounts were not recorded on the corporation's books. The decedent was then spending considerable sums of money, and Monroe asked him for an accounting, but it was refused. Considerable disagreement arose between the decedent and Monroe and the taxpayer's accountant concerning the failure to record its gross sales and costs, but the decedent nevertheless refused to disclose what he had done with the unrecorded corporate funds. (R. 21.)

The decedent was the dominant person in the management and control of the taxpayer corporation and Monroe was subordinate to his father. The decedent, who had a weakness for gambling, went to Florida on annual vacations for several months each winter and received money for these trips from Monroe. Because of the decedent's total domination of the corporation, however, no attempts were made by Monroe to curtail his father's lavish expenditures. Personal checks were drawn by the decedent to hotels and gamblers in Florida, and he purchased travelers' checks totalling as much as $10,000 in each of the years 1944 and 1945 alone. More-

over, Monroe purchased American Railway Express travelers' checks totalling $10,000 in 1944 for the decedent's convenience with funds derived from the secret bank accounts. Monroe, however, did not know how the decedent spent the money thus obtained. (R. 21, 35–36.)

The decedent acquired these corporate funds and all the others unreported and unaccounted for, aggregating almost $57,000, by withdrawing the money from the secret bank accounts for his own purposes, and by misappropriating the funds given him for the taxpayer's business purposes by Monroe who, dominated by his father and deceived as to his purposes in obtaining the taxpayer's funds, was unable to prevent his father's misuse thereof for his own personal use and benefit (R. 36–37).[2] After the decedent's death, cash in the sum of $25,000 was found in a vault kept in the name of his stepdaughter. Monroe, a coexecutor of his father's estate, was unaware of the existence of this money prior to the decedent's death. (R. 21, 36.)

It was conceded in the Tax Court that the corporation realized gross income from sales receipts to the extent of the deposits made by the decedent in the two secret bank accounts in the total sum of $196,870.60, and that none of these re-

[2] It was agreed by the parties in the Tax Court that all such funds which were taken by the decedent and were not returned to or expended on behalf of the corporation were withheld from and were due the corporation by the decedent (R. 22, 36).

ceipts were recorded on its books or included in gross receipts as reported on its tax returns filed for the several taxable years involved (R. 14, 25). Of the above total amount deposited to the corporation's credit in the secret bank accounts, approximately $135,000 was shown to have been spent for business purposes by the decedent on the corporation's behalf, and therefore was allowed by the Tax Court as offsets and deductions from the total secretly deposited by the decedent (R. 26–33). As to the remaining balance of $62,-054.23, unreported and wholly unaccounted for, the Tax Court rejected, for failure of proof, the taxpayer's contention that it was entitled to further deductions for more than that amount which purportedly represented certain items—all estimated and unproved in amount—paid for by the decedent on its behalf during the years 1943–1945 [3] (R. 27–30). Further, the Tax Court over-

[3] The net amount ($62,054.23) disallowed and charged against the taxpayer as taxable income (R. 30, 35) represents the difference between the total corporate receipts exceeding $196,000 secretly banked by the decedent (R. 14, 25) and the various items totalling $134,816.37 proved as having been expended by the decedent on behalf of the taxpayer (R. 26–27, 30, 32–33). This above sum of $62,054.23 was claimed by the taxpayer as a deduction representing (a) overceiling payments of *approximately* $25,000 purportedly made on its behalf by the decedent to black market waste paper dealers (R. 18, 28); (b) overceiling wages totalling *about* $28,800 allegedly paid in cash by the decedent to the taxpayer's production employees (R. 19, 29); (c) *approximately* $3,000 paid by the decedent as commissions over and

ruled, for lack of proof, the taxpayer's alternative contentions that $56,736.82[4] of the above amount in dispute represented a loss attributable to a misappropriation of corporate funds by the decedent and therefore was deductible by it as a loss sustained during the years 1938–1945 under Section 23 (f) of the 1938 Act and the 1939 Code, *supra*, p. 4 (R. 31–32).

The Tax Court accordingly charged the taxpayer with the amount of $62,054.23 as taxable income under the broad provisions of Section 22 (a) of the Revenue Act of 1938 and the Internal Revenue Code of 1939, *supra*, p. 3 (R. 30, 35). The Tax Court also found fraud against the taxpayer (as well as the decedent) (R. 24, 37–38), and charged it with 50% fraud penalties (except for 1945) under Section 293 (b) of the above-mentioned statutes, *supra*, p. 6, as statutory additions to the deficiencies in taxes redetermined against the corporation for all years involved (R. 39)—as it did against the decedent (R. 40). The court below affirmed as to all items above mentioned (Pet. 42–46).

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above the total amount thereof ($20,000) allowed by the Tax Court (R. 19, 30); and (d) overceiling extra amounts of salaries of $5,317.41 allegedly paid to the taxpayer's office and/or factory employees by vice-president Monroe (R. 19, 29).

[4] This net amount claimed as a corporate loss deduction represents the above-mentioned $62,054.23 less the item of $5,317.41 allegedly representing over-ceiling salaries paid to the taxpayer's employees by Monroe (R. 19, 29).

ARGUMENT

The decision of the court below is clearly correct and there is no conflict of decisions on the substantive tax questions involved. A brief discussion of the questions presented by the petition makes it plain that further review of the case by this Court is not called for.

1. It is first asserted that the taxpayer corporation should not have been held liable for the 50 percent addition to the tax which Code Section 293 (b), *supra*, p. 6, imposes where any part of a deficiency is due to "fraud with intent to evade tax" and that, even though Section 276 (a), *supra*, pp. 5–6, provides that there shall be no period of limitations where there is a "false or fraudulent return with intent to evade tax," the Tax Court erred in holding that the normal period of limitations had not expired (Pet. 2, 6–8). The theory of the taxpayer corporation is that it is not to be charged with the admitted fraud committed by the corporate officer who, acting as its president and treasurer, controlled its affairs and used his authority to prevent a substantial amount of the taxpayer's receipts from being recorded on its books or reflected in its tax returns. Because the unrecorded, unreported receipts were deposited in secret bank accounts and were used as a source from which this corporate officer misappropriated some part of the unreported receipts, it is urged

that the fraudulent understatements in its tax returns cannot be imputed to the corporation.

A corporation, however, acts only through its officers and agents and, when fraud or some illegal act is committed by a corporation, the acts in question must necessarily be performed by a human instrumentality. Here, in a family corporation, the fraudulent understatement of income in its tax returns was the result of actions undertaken by the officer who controlled its affairs and who was broadly empowered to act on its behalf. True, he also abused his authority in misappropriating corporate funds. But the corporation is not being held responsible for his personal fraud against it. Rather, it is being charged with the altogether different fraud committed against the Government when false corporate tax returns were filed during each of the years in question.

The record amply justifies the conclusion that the practically unlimited authority which reposed in the decedent as president and treasurer of the corporation was broad enough to encompass the filing of these false and fraudulent returns. The decision of the court below, in this respect, is in harmony with *Auerbach Shoe Co.* v. *Commissioner,* 216 F. 2d 693 (C. A. 1st); *Crescent Mfg. Co.* v. *Commissioner,* 181 F. 2d 185 (C. A. 6th), affirming the memorandum decision of the Tax Court entered August 31, 1948 (1948 P-H T. C.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

SIMON E. SOBELOFF,
Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK;
HILBERT P. ZARKY,
S. DEE HANSON,
Attorneys.

SEPTEMBER 1955.

U. S. GOVERNMENT PRINTING OFFICE: 1955

No. 321

HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

J. J. DIX, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

BERNARD WEISS,
Attorney for Petitioner,
136 East 57th St.,
New York 22, N. Y.

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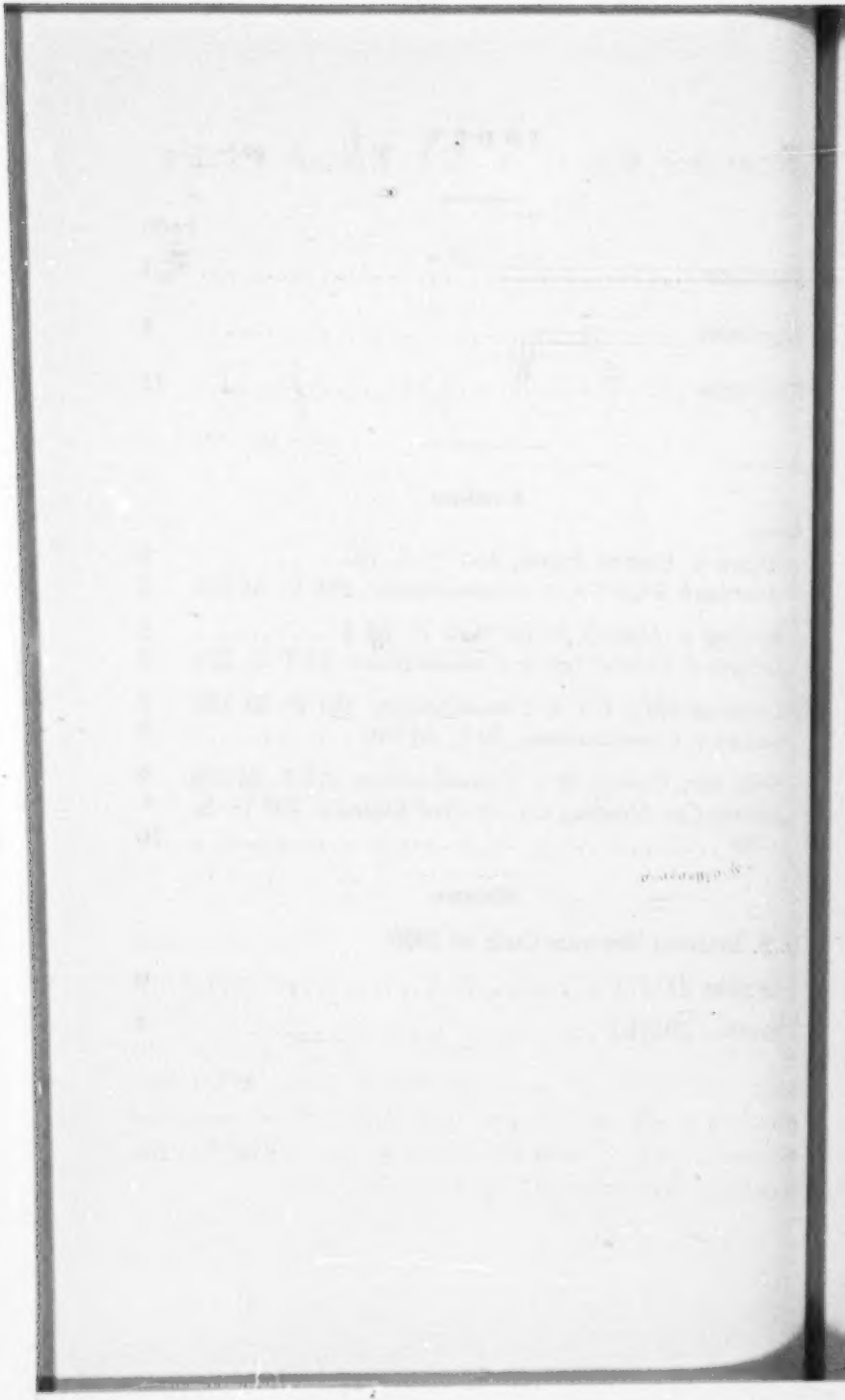

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

J. J. DIX, INC., *Petitioner,* v. COMMISIONER OF INTERNAL REVENUE, *Respondent.*	No. 321

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

STATEMENT

Subject to the following additional data, the resume of the Tax Court's findings in this case, as set forth in the Statement in the Respondent's Brief in Opposition is substantially correct.

It should be noted that the Sterling National Bank and the Public National Bank accounts which respondent states were opened by the decedent Jacob Dix were at all times corporate bank accounts and deposits into these two corporate bank accounts were not secretly made. What was unknown to the stockholders and other officers was that the transactions in these accounts were not reflected on the books and tax returns of the corporation.

Monroe Dix, Vice President in charge of Sales and son of the decedent, Jacob Dix, was a party to the original consolidated proceedings and was found by the Tax Court to be wholly innocent of wrongdoing or participation in any alleged fraud resulting from the omission of any net income due to the failure to reflect on the corporate books the two unrecorded bank accounts. In fact, as to all disputed issues, including alleged fraud, the Tax Court determined that no amounts were received by Monroe Dix as income from the two bank accounts and sustained his contention with respect thereto.

The respondent has failed to note that the Tax Court did find there existed the practice of wastepaper dealers demanding and receiving an overceiling payment in connection with deliveries to mills of wastepaper for the account of designated manufacturers of paper boxes, and that the excess prices varied from $5 to $15 per ton over the OPA ceiling price. The actual tonnage of wastepaper to at least one paperboard mill (Continental Paper Corporation) was acknowledged by the Tax Court though no allowance of any kind was made.

In addition, the Tax Court made the following significant finding:

> "The petitioner-corporation's failure to report all of its gross income and to pay taxes upon its proper net income was due to the fraud of its president, Jacob Dix. Jacob, as president of the corporation, without the knowledge or assistance of Monroe, had kept deposits of sales proceeds from being included on the corporate records or reported for tax purposes. Monroe was of the mistaken opinion that all corporate sales were reflected on the tax returns and did not discover his error until 1945. He then

brought the matter to the attention of respondent's agents.

As noted above, the failure of the corporation to file proper returns is not due to fraud on the part of Monroe, but Jacob as president of the corporation was clearly guilty of fraud in filing corporate returns. The wilfull failure to report corporate income from sales proceeds, known to have been received and deposited in corporate bank accounts, leaves no conclusion to be drawn other than fraud.

No reason has been suggested for the failure to report sales receipts deposited in these accounts other than that the corporation's principal officer wished to appropriate funds for his own purposes without paying taxes.

We hold that the corporation, acting through Jacob Dix as its agent, must be held responsible for the fraud of its president in filing false corporate returns."

The Circuit Court also found:

"Jacob withdrew those monies from the corporate bank accounts without the consent, coerced or otherwise, of the company. That he was the president did not amount to corporate consent."

The respondent inadvertently stated (RB 15) that the court below affirmed the Tax Court decision that Jacob was liable for the 50% fraud penalty. This is incorrect; the court below having reversed the Tax Court as to the taxability of embezzled funds, the fraud penalty was of course eliminated.

ARGUMENT

I.

The respondent, in his Argument I, sets up a "straw man" that he then proceeds to knock down.

There is no dispute that a corporation that files a fraudulent income tax return is liable to the fraud penalty of 50% of the deficiency in tax, in accordance with Section 293(b) of the U. S. Internal Revenue Code of 1939, or that in cases (of fraud) that the Statute of Limitations is no bar and that the deficiency and penalties could be assessed at any time. Nor is there any question that a corporation, being an artificial being, must act through a human instrumentality. Such fraud as exists in this case deals with the embezzlement of funds of the corporation by its president.

The broad power to act on behalf of any corporation does not, as a matter of law, include the right to steal from the employer. It is elementary that when an officer of a corporation misappropriates corporate funds for his own personal benefit he ceases to act as agent and his agency terminates and his fraudulent act does not bind the corporation. In this case the misdeeds of the president were not known to the officers or stockholders of the corporation prior to 1945, nor were the misappropriations condoned or approved.

To say, as the respondent contends, that the corporation is not being held responsible for the personal fraud of the president against it, and at the same time urge that the corporation be taxed on the income of which it was deprived by the president's misappropriations and also be subjected to a 50% fraud penalty, together with all the

odium that accompanies such penalty, seems to be wholly irreconcilable as well as unjust. The cases cited by the respondent are wholly dissimilar.

In *Auerbach Shoe Co.*, 216 F. 2d 643 (CA-1), cited by the respondent, the president and 100% stockholder of the corporation sold certain goods from the corporation's stock of merchandise in 1944 and 1945 and retained the proceeds. The profit was not reported and the 50% fraud penalty was properly imposed. The corporation was merely an incorporated pocketbook of the individual.

In the case of *Crescent Mfg. Co.* v. *Commissioner,* 181 F. 2d 185 (CA-6), the treasurer of the corporation withdrew sums of money from the corporation by paying fictitious bills and by crediting sales proceeds as amounts due officers, and then withdrawing these credits. This money was then divided up among all the officers and stockholders. Since all the officers and stockholders knew and participated in the fraud, the 50% fraud penalty was properly asserted.

In the case of *Battjes* v. *U. S.*, 172 F. 2d 1 (CA-6) the petitioner was indicted for income tax evasion arising out of failure to report all of his personal income. This case has nothing whatsoever to do with the issue raised by the petitioner in this proceeding.

For the reasons stated, the cases cited by the respondent are not comparable.

On the question of corporate responsibility for the acts of an officer, attention is called to the case of *Berger & Sherin, Inc.* v. *Commissioner,* 13 T. C. 221, wherein Joseph Berger, a 50% stockholder and president of the corporation in charge of sales, entered into an arrangement whereby overceiling payments were received by him in connection with the sale of scarce rayon materials to the corporation's

customers, which he personally kept and of which the other 50% stockholder knew nothing, and derived no benefit. In that case, the Commissioner of Internal Revenue claimed that the acts of the president in receiving the overceiling payments were within the apparent scope of his authority and therefore such profits were to be treated as corporate income. The Commissioner contended the failure to report such income by the corporation was to be considered as wilfull and a 50% fraud penalty was therefore asserted. In that case, as in the present case, the corporate return was signed by the president.

The Tax Court held that illegal acts of the president cannot be attributed to the corporation and furthermore the corporation neither benefited nor approved the president's acts, nor did it seek any share of the ill-gotten gains of the president. This is a case which clearly indicates that the Court will not lightly disregard the rules of agency so as to treat an agent's acts for his own benefit to the detriment of the principal as acts of the principal.

II.

The respondent in his second argument contends that since the Tax Court, based on evidence submitted at the trial, has allowed approximately $135,000 for various items to be offset against $196,000 of omitted sales, the Tax Court's failure to allow any further amounts necessarily means that the evidence was "so vague and conjectural as to render it impossible" for the Tax Court to even approximate the claimed deductions.

The respondent misses the point raised in the petition. The Tax Court made the finding that "It was common

knowledge in the trade that many customers of the Continental Paper Co. were paying sums of money over the ceiling price to the wastepaper dealers for paper stock. The shippers for such wastepaper were not usually the regular suppliers of the Continental Paper Co. * * * The practice of the wastepaper shipper designating a manufacturer of paperboard was not a common trade practice but existed in 1943, 1944 and 1945 when supplies were inadequate. * * * An overceiling price was required to be paid and the amount varied from $5 to $15 per ton. * * * Cash was paid to the dealers to induce them to deliver the wastepaper to the mills. Dealers delivered wastepaper to mills for the credit of J. J. Dix, Inc."

The Tax Court also found salaries paid to production workers qualified as part of the cost of goods sold. However, the amount paid by Monroe to workers engaged in production rather than those engaged in office work was not known and no basis existed for making an estimation.

Again, the Tax Court stated—

> "The amounts deposited to the corporation's regular bank account, the amounts expended for overceiling payments to wastepaper dealers, commissions, and the amounts spent for other corporate purposes were not misappropriated. The amounts expended for overceiling payments to wastepaper dealers have not been established and we do not know how much was misappropriated."

These findings by the Tax Court, approved by the Circuit Court, that amounts *were* spent for corporate purposes but that the amounts were difficult to estimate and therefore nothing was being allowed to this taxpayer are in direct conflict with the ruling in *Cohan* v. *Commissioner*,

39 F. 2d 540 (which ruling has been accepted and is followed in almost all circuits) viz:

> "* * * the Board (now the Tax Court) should make as close an approximation as it can, bearing heavily, if it chooses, upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all, appears to us inconsistent with saying that something was spent."

Since this principle of law has gained wide acceptance in all circuits and is apparently being ignored by the court below in this case, this Honorable Court should review the issue, to the end that the law may be definitely stated for guidance of the courts and attorneys.

What the Tax Court in effect has said is that a(wages) + b(wastepaper) + c(misappropriations) = $56,736.82; and although each of the items is allowable separately, since the specific amount of any one of them is not known, no deduction may be granted for any of the items. Petitioner contends since each item making up the $56,736.82 is an allowable deduction, the aggregate of the three items is an allowable deduction whether it be as "a" or "b" or "c", or a combination of said items.

The Tax Court ruling is curious in that it had no difficulty in determining the amount embezzled was $56,736.82 for the purposes of taxing the Estate of Jacob Dix for the period 1938 to 1945 inclusive, but it was unable to come to the same conclusion as to this corporate taxpayer.

III.

The respondent urges this Court not to review the question presented by the petitioner that the Court below ignored the ruling of this Court in *Alison* v. *U. S.*, 344 U. S.

167, wherein this Court found that a loss from embezzlement may be claimed and allowed in the year of discovery of such embezzlement. The respondent asserts that this question does not arise because the taxpayer failed to prove the loss was incurred since he alleges the taxpayer did not show it could not collect from the Estate of Jacob Dix, and that Section 23(f) of the U. S. Internal Revenue Code of 1939 only grants a deduction for losses sustained and not compensated for by insurance or otherwise. Respondent cites the case of *Geo. M. Still, Inc.* v. *Commissioner,* 218 F. 2d 609 (CA-2) which is clearly inapplicable.

In the *Still* case, amounts of money representing sales were held out from income of the corporation by two officers who were stockholders. The president of the corporation and principal stockholder found out about this misappropriation before the end of the taxable year and had procured an agreement from the stockholders to repay the amounts illegally withheld and misappropriated. In the next year the full amount of the loss was recovered. The Tax Court properly held the corporate return to be incorrect for the reasons that the acts of its officers were condoned and furthermore no loss was incurred, since the full amount was subsequently recovered. The fraud penalty was sustained since the president of the corporation knew that the sales were omitted and further had a commitment for repayment from these stockholders before the close of the taxable year and before the due date for filing the tax return. He had no right to file the return leaving out the omitted sales since he knew the sales reported were false. The facts in the *Still* case are not comparable and the case is not a basis for refusing review.

On the other hand, in the instant case there is no question (1) that the embezzlement occurred and that this amount has not been recovered by the taxpayer; (2) that the loss of the taxpayer was not covered by insurance or otherwise; (3) that demand was made on the executor of the Estate of Jacob Dix and no payment of any kind was received; (4) the Tax Court records show that the amount of the proposed deficiencies plus additions to tax asserted against the Estate of Jacob Dix exclusive of interest was $90,269.89 for the years 1938 to 1945 (this liability the Tax Court reduced to $41,600 plus interest); and that the Estate of the decedent in January 1952 (the date of taking of deposition of Monroe Dix before the Tax Court) had cash of $29,500 and marketable securities valued at $17,000. So it was quite evident that the corporation could not collect any amount alleged to be due from the Estate. In any event, no executor would pay out any amount on account of this taxpayer's claim, even if admitted to be owing in full, in view of the Commissioner's claim for taxes due, which exceeded the value of the Estate.

What this taxpayer has against the Estate of Jacob Dix is only a claim and until such claim is finally determined and settled by judgment or otherwise, no taxable income arises. This Court, in *U. S.* v. *Safety Car Heating Co.*, 297 U. S. 288, held in effect that uncollected income, which is the subject of any important contest, dispute or controversy, does not become taxable income until such time as the differences are resolved.

Since the court below found that the embezzlement was not condoned and that the knowledge of the president (Jacob Dix) did not amount to corporate consent, there is no justification in the record for the respondent to state

that the members of the family are disinclined to recover from the Estate and therefore no loss can be allowed.

For the reasons set forth herein the Court should review this issue.

CONCLUSION

The petitioner, having shown the errors of the court below, and that the principles of law are of general importance in the administration and interpretation of the Tax Statutes, and having established that a conflict does exist among the various circuits in applying the principles of law with respect to the issues raised in this petition, it is respectfully urged that a writ of certiorari be issued to the U. S. Court of Appeals for the Second Circuit.

BERNARD WEISS,
Attorney for Petitioner,
136 East 57th St.,
New York 22, N. Y.

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF JACOB J. DIX, DECEASED

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit.[1]

[1] This case was consolidated for hearing and decision with the companion case, *J. J. Dix, Inc.* v. *Commissioner*, in both courts below, all the issues involved in the latter having been decided in favor of the Commissioner. (R. 3, 7, 9–38, Appendix, *infra*, pp. 1a–6a.) The corporate taxpayer's petition for a writ of certiorari to the Court of Appeals for the Second Circuit in that case was filed in this Court on August 13, 1955 (No. 321, Oct. Term 1955).

The record citations herein refer to the separate joint Appendix (record on review) filed by both taxpayers in these cases together with their joint brief in the court below.

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court of the United States (R. 9–38) are not officially reported. The opinion of the Court of Appeals (Appendix, *infra,* pp. 1a–6a) has not yet been officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on June 2, 1955. (Appendix, *infra,* pp. 6a–7a.) The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the deceased taxpayer realized taxable income when he secretly misappropriated for his own use and benefit funds from a family-owned corporation in which he had a beneficial interest and over which he, as president and treasurer, exercised complete domination and control.

STATUTES INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also

from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

Sections 22 (a) and 293 (b) of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Secs. 22, 293), applicable to the taxable years 1939 to 1945, inclusive, are substantially the same as Sections 22 (a) and 293 (b) of the Revenue Act of 1938, *supra,* applicable to the taxable year 1938.

STATEMENT

The pertinent facts as found by the Tax Court (R. 12–24), based on those stipulated by the parties (R. 12) and upon the evidence (including exhibits) adduced at the hearing, may be summarized as follows:

The decedent-taxpayer, Jacob J. Dix (herein called the taxpayer), was president and treasurer

and controlled the affairs of a family corporation, J. J. Dix, Inc. (hereafter referred to as the corporation), a New York corporation engaged in the manufacture of paper boxes. His son, Monroe L. Dix, was vice-president and a director of the corporation. The corporation's stock was owned by Monroe and two other children of the taxpayer. Although the taxpayer owned none of the corporate stock directly, he had a life estate in a trust owning one-third and later one-fourth of the corporation's outstanding stock, under which he was entitled to the dividends for his life. (R. 12–14.)

During the taxable years 1938 through 1945, the taxpayer, through his position of dominance over the affairs of the corporation, appropriated to his own use corporate funds of approximately $56,000. (R. 14, 25.) He accomplished this in the following manner:

The corporation's regular business bank account was maintained with the Manufacturers Trust Company. In 1938, the taxpayer opened a separate bank account in the name of the corporation with the Sterling National Bank and Trust Company. This account was closed in 1942. Thereafter, in 1943, he opened another account in the name of the corporation with the Public National Bank. This account was closed in 1945. Deposits of corporate funds were secretly made by the taxpayer in the latter two bank accounts in the total sum of $196,870.60 during the years

1938 through 1944 so that the Manufacturers Trust Company, the corporation's regular banker, would not know that another bank account existed. None of those secret deposits was ever reflected on the corporation's books or reported on its tax returns for any of those years. All of the deposits made by the taxpayer in these secret bank accounts represented proceeds of merchandise manufactured and sold by the corporation in the regular course of its business. (R. 14, 15, 20.)

All checks drawn on these secret bank accounts were signed by, and a substantial number were drawn to the order of, the taxpayer and/or his son Monroe, and many were drawn to cash. The taxpayer drew numerous checks on the corporation's unrecorded account at the Sterling National Bank and deposited the funds in his individual bank account at the Bronx County Trust Company. Monroe, drawing checks from time to time on the corporation's regular business account, also drew checks on the secret account in the Sterling National Bank as well as on other banks, and turned the funds over to the taxpayer. During 1939–1944, Monroe also drew checks, made payable to the taxpayer, in excess of $33,000 on his own personal bank accounts, which were deposited in the taxpayer's personal bank accounts. Monroe had no knowledge of how the taxpayer spent this money. (R. 14–15.)

The taxpayer had said that he had opened the two secret bank accounts because he was going

to use the deposits for purposes which he could not reveal. He also declared that he was paying extra amounts of money to waste paper dealers, but the records of the corporation failed to reflect any such payments. No items drawn from the corporation's secret bank accounts were identified on the corporation's books. The taxpayer never informed Monroe of the fact that all the corporate sales were not being recorded on the corporation's books. (R. 20.) Moreover, the amounts withdrawn by both the taxpayer and Monroe from the two secret bank accounts were not reflected on any of their personal tax returns filed for the years 1938–1945, or in the net worth of either. (R. 16, 21–22.)

In April, 1945, Monroe first discovered that the deposits in and the withdrawals from the two secret bank accounts were not recorded on the corporation's books. The taxpayer was then spending considerable sums of money, and Monroe asked him for an accounting, but it was refused. Considerable disagreement arose between the taxpayer and Monroe and the corporation's accountant concerning the failure to record its gross sales and costs, but the taxpayer nevertheless refused to disclose what he had done with the unrecorded corporate funds. (R. 21.)

The taxpayer was the dominant person in the management and control of the corporation and his son Monroe was subordinate to him. The taxpayer, who had a weakness for gambling,

went to Florida on annual vacations for several months each winter and received money for these trips from Monroe. Because of the taxpayer's total domination of the corporation, however, no attempts were made by Monroe to curtail his father's lavish expenditures. Personal checks were drawn by the taxpayer to hotels and gamblers in Florida, and he purchased travelers' checks totaling as much as $10,000 in each of the years 1944 and 1945 alone. Moreover, Monroe purchased American Railway Express travelers' checks totalling $10,000 in 1944 for the taxpayer's convenience with funds derived from the secret bank accounts. Monroe, however, did not know how the taxpayer spent the money thus obtained. (R. 21, 35–36.)

After the taxpayer's death, cash in the sum of $25,500 was found in a vault kept in the name of his stepdaughter. Monroe, a co-executor of his father's estate, was unaware of the existence of this money prior to the taxpayer's death. (R. 21, 36.)

It was conceded in the Tax Court, on behalf of the taxpayer, that the corporation realized gross income from sales receipts to the extent of the deposits made by the taxpayer in the two secret bank accounts in the total sum of $196,-870.60, and that none of these receipts was recorded on its books or included in gross receipts as reported on its tax returns filed for the several taxable years involved. (R. 14, 25.) Of the total

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amount deposited to the corporation's credit in the secret bank accounts, approximately $135,000 was shown to have been spent on the corporation's behalf. (R. 26–33.) The balance of these funds, however, had been withdrawn by the taxpayer from the corporation's secret bank accounts and was neither returned by him to the corporation nor expended on its behalf. (R. 35–36.)

The Tax Court determined that the missing portion of the money, approximately $56,000,[2] had been appropriated by the taxpayer for his own purposes and represented income which was taxable to him under the broad provisions of Section 22 (a) of the Revenue Act of 1938 and the Internal Revenue Code of 1939, *supra*. (R. 35–37.) The Tax Court also found fraud against the taxpayer (as well as the corporation) (R. 24, 37–38), and charged him (and the corpora-

[2] This net amount ($56,736.02) charged against the decedent-taxpayer as taxable income (R. 35–36) represents the difference between the total corporate receipts exceeding $196,000 secretly banked by him (R. 14, 25) and the various items totalling $134,816.37 proved as having been expended by him in behalf of the corporation (R. 26–27, 30, 32–33, 35), less the sum of $5,317.41 claimed by Monroe to have been paid out by him in behalf of the corporation during 1943–1945 (R. 19). The latter amount was disallowed by the Tax Court for lack of proof (R. 29), and the court below affirmed (Appendix, *infra*, p. 3a).

It was agreed by the parties in the Tax Court that all such funds which were taken by the taxpayer and were not returned to or expended on behalf of the corporation were withheld from and were due the corporation by the taxpayer. (R. 22, 36.)

tion) with 50% fraud penalties, under Section 293 (b) of those statutes, *supra,* as statutory additions to the deficiencies in taxes redetermined against him for all years involved (R. 40, 39). The court below reversed, holding that this money had been embezzled by the taxpayer and did not represent taxable income to him. (Appendix, *infra,* pp. 4a–5a.)

REASONS FOR GRANTING THE WRIT

In *Commissioner* v. *Wilcox,* 327 U. S. 404, a divided Court held that an embezzler was not liable for income tax on the sums embezzled. In *Rutkin* v. *United States,* 343 U. S. 130, a divided Court held that an extortionist did receive taxable income and (p. 138) limited *Wilcox* "to its facts." Because the decision below is in conflict with the decision of the Third Circuit in *Kann* v. *Commissioner,* 210 F. 2d 247, certiorari denied, 347 U. S. 967, because the court below, notwithstanding that this Court limited *Wilcox* to its facts, has applied the *Wilcox* decision to the totally different circumstances of this case, and because of the well-founded uncertainties that exist in the lower courts whether *Rutkin* and *Wilcox* can be reconciled, the decision below raises problems of importance to the revenue and should be reviewed by this Court.

1. The decision below is in direct conflict with *Kann* v. *Commissioner, supra.* That case likewise

involved misappropriations of corporate funds by the principal officers from two wholly-dominated family corporations, and the Third Circuit—Judge Kalodner dissenting—held that their misappropriations resulted in the receipt of taxable income under the rule of the *Rutkin* case. The court there considered that this Court's earlier decision in *Wilcox* was distinguishable on its facts,[3] and that it was not material to determine whether the taxpayers in *Kann* were technically guilty of embezzlement under local law, although it did point out that there was no external evidence that such an offense had been committed, there having been, as is also true in the present case, no indictment or conviction or even any indication of pressure for prosecution by the other stockholder-members of the taxpayer-officers' families.

Kann and the present case are on all fours, except for immaterial differences. In both cases,

[3] The following distinctions were pointed to by the Third Circuit in *Kann* (pp. 250–251): (a) the taxpayers there, unlike Wilcox, were never prosecuted for the embezzlement; (b) Wilcox was not forgiven by his victim, but in *Kann* there was no proof that the unauthorized withdrawals of funds from the corporation were not condoned by the family-member stockholders; (c) taxpayers Kann were able to make restitution, but Wilcox was not; (d) Wilcox was merely a salaried employee, whereas taxpayers Kann owned directly and beneficially their two wholly dominated employer-corporations; (e) taxpayers Kann resorted to fraud over a period of six years in pursuance of a clear tax evasion scheme, absent in *Wilcox*. Substantially all of these distinctions also exist in the present case.

the misappropriating taxpayers were the principal corporate officers and, though not stockholders, owned beneficial interests in the respective family corporations which they dominated.[4] In both cases, the dominant corporate officers utilized their respective positions to divert corporate funds to their own use and benefit and asserted personal dominion over the diverted monies. The Third Circuit held that the officers in *Kann* realized taxable income by their misappropriations. The court below, making no attempt to distinguish *Kann*, and relying instead on the dissent in that case, has reached the opposite conclusion.

2. The conflict between the present decision and the *Kann* case brings into sharp focus, as is noted in Judge Hincks' dissenting opinion below (Appendix, *infra*, pp. 5a–6a), the difficulty of attempting to reconcile *Wilcox* and *Rutkin*. The four dissenting Justices in *Rutkin* considered (p. 140) that "beyond doubt" the majority there had rejected "the Wilcox interpretation of Section 22 (a)". That *Rutkin* at least went far in this direction is abundantly clear from the categorical holding in *Rutkin* (pp. 137–138) that—

[4] Taxpayers Kann held no stock in the Globe Steel Abrasive Company, one of the corporations from which they misappropriated the funds there in question. That was a wholly owned subsidiary of the Pittsburgh Crushed Steel Company in which they, together with members of their families, owned at least 90 per cent of the stock during all years involved, except 1936. *Kann* v. *Commissioner*, *supra*, p. 251.

> There has been a widespread and settled administrative and judicial recognition of the taxability of unlawful gains of many kinds under Section 22 (a). The application of this section to unlawful gains is obvious from its legislative history. * * *
>
> There is little doubt now that where unlawful gains are secured by the fraud of the taxpayer they are taxable.

The Court said further (p. 137) that—

> There is no adequate reason why assailable unlawful gains should be treated differently in this respect from assailable lawful gains. Certainly there is no reason for treating them more leniently. * * *

It was, of course, not necessary to the decision in *Rutkin* that *Wilcox* be expressly overruled. But, by limiting *Wilcox* to its facts without further indicating whether that case still possessed vitality as a precedent, the *Rutkin* opinion has proved to be a source of difficulty to the lower courts. Thus, although the majority in *Kann*, referring to this Court's decisions, found (p. 249) "a conflict of views", it concluded that *Rutkin* was controlling (p. 250) "in view of the gloss put on the *Wilcox* case by the *Rutkin* decision." It proceeded, as we have noted (fn. 3, *supra*, p. 10), to enumerate all the possible facts which would distinguish *Kann* from *Wilcox*.[5] Judge

[5] Compare *National Carbide Corp.* v. *Commissioner*, 336 U. S. 422, 427–433, for a comparable treatment of *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, another case that had been previously limited to its facts.

Kalodner, in his dissent in *Kann*, expressed the views that *Wilcox* still governs whenever the unlawful income is derived by embezzlement, that the lower courts ought not to assume that *Wilcox* was, in effect, overruled by *Rutkin* since (p. 252) "the Supreme Court of the United States can and should speak for itself", and (*ibid.*) that "[u]ntil the Supreme Court tell us otherwise, we are required to follow *Wilcox* in embezzlement cases."

The majority of the court below, like Judge Kalodner in *Kann*, did not think (Appendix, *Infra*, pp. 4a–5a) that "Rutkin completely obliterated Wilcox," and held that the latter rather than the former governed "a simple case of embezzlement." Judge Hincks, in his dissenting opinion, while sharing the difficulty of distinguishing the rationale of *Rutkin* from that of *Wilcox*, thought that the facts here are closer to the former, and added (Appendix, *infra*, p. 6–a), "And if such facts are not enough to distinguish the case here from *Wilcox*, I think the court below was right in following the later pronouncement of the Supreme Court."

In other cases, too, the lower courts, in the intervening 3½ years since the decision in *Rutkin* was handed down by this Court (March 24, 1952), have made evident their uncertainty as to the status of *Wilcox* in view of the Court's statement in *Rutkin* (p. 138) that the factual

United States Court of Appeals for the Second Circuit

Nos. 23–24, October Term, 1954

Argued April 21, 1955—Decided June 2, 1955

Docket Nos. 22989–90

J. J. Dix, Inc., petitioner

v.

Commissioner of Internal Revenue, respondent

Estate of Jacob J. Dix, deceased, petitioner

v.

Commissioner of Internal Revenue, respondent

Before: Frank, Medina and Hincks, *Circuit Judges.*

Appeal from decisions of the Tax Court of the United States, Judge Van Fossan. Affirmed as to *J. J. Dix, Inc.* v. *Commissioner;* reversed as to *Estate of Jacob J. Dix* v. *Commissioner.*

Frank, Circuit Judge:

The facts and rulings of the Tax Court are set forth in the opinion of Judge Van Fossan, reported unofficially in 12 T. C. M. 536.

I

The Corporate Taxpayer's Appeal

The Tax Court found that the corporate taxpayer, during the years 1938 through 1944, realized net taxable income amounting to $62,054.23 in excess of the amounts recorded on its books and reported on its tax returns filed for those years. It is undisputed that the corporation during the above period realized from its sales the sum of $196,870.60 which was secretly deposited in two banks, and that the amounts so received were not recorded on its books or included in gross receipts on its tax returns. The Commissioner, in determining the deficiencies, increased the corporation's annual sales income, by that amount, without allowing a deduction, because it was not recorded on the corporation's books as required by Sections 41 and 54 (a) of the Internal Revenue Code of 1939.

The Tax Court found, and taxpayer conceded, that the corporate gross income had been understated in the total sum of $196,870.60. It found further, however, that the corporation was entitled to deductions aggregating $134,816.37, and therefore that its taxable income had been fraudulently understated and unreported in the remaining sum of $62,054.23, redetermining the deficiencies and fraud penalties accordingly.

Taxpayer contends that the corporation is entitled, in addition to the deductions allowed by the Tax Court, to further deductions exceeding $62,000 as follows: (a) overceiling payments of approximately $25,000 purportedly made in behalf of the corporation by its president, Jacob Dix, to black-

market wastepaper dealers; (b) overceiling wages totalling about $28,800 allegedly paid in cash by Jacob to the corporation's production employees; (c) approximately $3,000 paid by Jacob as commissions over and above the total amount thereof ($20,000) allowed by the Tax Court; and (d) overceiling extra salaries of $5,317.41 allegedly paid to the corporation's office and factory employees by vice-president Monroe Dix. The Tax Court, for failure of proof, denied the deduction of these additional items, and the taxpayers assert that this is error. We submit that there is no merit in these contentions.

We think the Tax Court's decision correct. Judge Van Fossan's opinion, analyzing in detail the taxpayer's evidence, shows that taxpayer did not discharge its proof-burden. And its proof left the matter so vague and conjectural as to render it impossible, as the Tax Court held, to apply the doctrine of *Cohan* v. *Commissioner*, 39 F. (2d) 540 (C. A. 2).

Taxpayer contends, alternatively, that the sum of $56,736.82, out of the total unreported sales proceeds, represents corporate funds misappropriated by Jacob, and therefore the corporation is entitled to deduction of this sum as a loss sustained during the years 1938 through 1945, under Section 23 (f) of the 1939 Code. The Tax Court found, we think correctly, that the taxpayer did not show the amount of the misappropriation or the years in which misappropriations occurred. It said: "No basis exists in the evidence to make an estimation of the amount of money improperly taken by Jacob. For this reason, the deductions

for any losses sustained as a result of misappropriated funds must be denied the corporation." Moreover, there was no proof that the corporation will not recover from Jacob's estate whatever amounts he did misappropriate.

The evidence, and entirely reasonable inferences drawn from the evidence, demonstrate that the Commissioner discharged the burden of establishing fraud by clear and convincing evidence of wilful intent to evade taxation, and that therefore the imposition of 50% fraud penalties was justified. Because of the fraud, the statute of limitations was inoperative.

The adjustment of income for the several taxable years caused over-assessments of excess profits for other years. Taxpayer contends that it is entitled, as an equitable setoff against deficiencies, to refunds of such over-assessments, although such refunds are barred by the statute of limitations. We do not agree. See *Babcock & Wilcox Company* v. *Pedrick,* 212 F. (2d) 645, 648–649 (C. A. 2).

II

The Estate of Jacob J. Dix

The Tax Court held that Jacob Dix realized taxable income of $56,736.82, i. e., the amount of corporate funds he misappropriated. We think this was error. Jacob withdrew those moneys from the corporate bank accounts without the consent, coerced or otherwise, of the company. That he was the president did not amount to corporate consent. We have here a simple case of embezzlement, not one involving a receipt under any color of right. Accordingly, we think

Commissioner v. *Wilcox,* 327 U. S. 404, governs, and that *Rutkin* v. *United States,* 343 U. S. 130, does not apply. We do not believe that *Rutkin* completely obliterated *Wilcox.* "Since the court in *Commissioner of Internal Revenue* v. *Wilcox* flatly held that embezzled funds were not taxable income to the embezzler and in the Rutkin case has unequivocally held that funds were taxable income to the extortionist, the line of demarcation lies between those rather closely related factual situations and must be determined by the facts in the individual case." *Marienfeld* v. *United States,* 214 F. (2d) 632, 637 (C. A. 8) [certiorari denied, 348 U. S. 865]. In the instant case, the facts are close to those of Wilcox, and lack the distinguishing features found in *United States* v. *Bruswitz,* 219 F. (2d) 59 (C. A. 2) [certiorari denied, 349 U. S. 913], and cases there cited. See also the dissent of Judge Kalodner in *Kann* v. *Commissioner,* 210 F. (2d) 247, 253 (C. A. 3) [certiorari denied, 347 U. S. 967].

Affirmed as to J. J. Dix, Inc.; reversed as to Estate of Jacob J. Dix.

HINCKS, *Circuit Judge* (dissenting in part):

Although I concur in the holding of the court in so far as it affirms the decision below, I am unable to join in the partial reversal. I share the difficulty which this court had in *United States* v. *Bruswitz,* 219 F. 2d 59 [(C. A. 2), certiorari denied, 349 U. S. 913], in distinguishing the rationale of *Commissioner* v. *Wilcox,* 327 U. S. 404, from that of *Rutkin* v. *United States,* 343 U. S. 130. But having in mind the findings below—well supported by the record—that Jacob Dix, who dominated the corporate taxpayer, a family

corporation, by deceiving his son, who was the only other responsible corporate executive, fraudulently witheld the entry of corporate receipts from the corporate books and utilized his authorized power to draw on corporate bank accounts by diverting funds to his own personal use, I think the facts here are stronger against the taxpayer than in *Wilcox* and come within the rationale of the *Rutkin* case. Cf. *Kann* v. *Commissioner,* 210 F. 2d 247 [(C. A. 3), certiorari denied, 347 U. S. 967]; and *Marienfeld* v. *United States,* 214 F. 2d 632 [(C. A. 8), certiorari denied, 348 U. S. 865]. And if such facts are not enough to distinguish the case here from *Wilcox,* I think the court below was right in following the later pronouncement of the Supreme Court.

Judgment

United States Court of Appeals Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 2nd day of June one thousand nine hundred and fifty-five.

Present: Hon. JEROME N. FRANK, Hon. HAROLD R. MEDINA, Hon. CARROLL C. HINCKS, *Circuit Judges.*

ESTATE OF JACOB J. DIX, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed in accordance with the opinion of this Court.

[S] A. DANIEL FUSARO, *Clerk.*

A true copy,

[S] A. DANIEL FUSARO, *Clerk.*

FILED JUN 2, 1955.

U. S. GOVERNMENT PRINTING OFFICE: 1955

SEP 19 1955
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

No. 363

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ESTATE OF JACOB J. DIX, Deceased.
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Memorandum for the Respondent.

BERNARD WEISS,
Attorney for Respondent
136 East 57th Street
New York 22, N. Y.

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IN THE

Supreme Court of the United States

OCTOBER TERM 1955

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*, v. ESTATE OF JACOB J. DIX, Deceased.	No. 363

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Memorandum for the Respondent.

Opinions Below

Memorandum findings of fact and opinion of the Tax Court of the United States (R. 9-38) are not officially reported. The opinion of the Court of Appeals (Pet. 1a-6a) is officially reported in 223 Fed. 2nd 436.

Jurisdiction

The judgment of the Court of Appeals was entered on June 2, 1955. (Pet. 6a-7a) The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254.

Questions Presented

1. Whether the deceased taxpayer realized taxable income when he embezzled funds for his own use and benefit to the detriment of the stockholders and the family-owned corporation in which the taxpayer owned no stock?

In the event the Court grants certiorari on the above issue, the taxpayer will urge the following questions for review:

2. Whether the wording of the Statutory Notice of Deficiency sent by the petitioner to the taxpayer and the agreement of the parties to this proceeding, that any amount drawn by Monroe Dix and Jacob Dix from the two omitted bank accounts of the corporation and not returned to or spent on behalf of the corporation was withheld from and is due to the corporation, precludes taxing said amount as income to the deceased taxpayer?

3. Whether the determination of the Tax Court of the United States that Jacob J. Dix derived taxable income of $56,736.82 from misappropriated funds is correct in view of its own findings that a substantial part of that amount was spent for overceiling payments for wastepaper to obtain a supply of paperboard for the corporation, and possibly for overceiling wage payments, but for which no allowance was made on the ground that a computation of such amount was too difficult or speculative to determine?

4. Whether the inability of the deceased taxpayer to prove the payment of corporate expenses with corporate funds received by him results in taxable income to the deceased taxpayer? And if such be the case, whether the omission of such amounts from the income tax return of the deceased taxpayer, standing alone and by itself, is proof of fraud?

5. Are the assessments of deficiencies in taxes against the deceased taxpayer for the calendar years 1938 through 1941 barred by Section 275 of the Revenue Act of 1938 and the Internal Revenue Code of 1939?

6. Was the income tax liability of the deceased taxpayer for the calendar year 1942 discharged by Section 6 of the Current Tax Payment Act of 1943?

Statutes Involved

The statutes involved are those set forth in the petition. (Pet. 2-3)

The additional statutes involved on the questions that the taxpayer will urge for review are:

Revenue Act of 1938, c. 289, 52 Stat. 447:

Sec. 275. Period of Limitation upon Assessment and Collection.

Except as provided in section 276—

(a) General Rule. The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Sec. 276. SAME. EXCEPTIONS

(a) False Return or No Return. In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) Waiver. Where before the expiration of the time prescribed in Section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

Sections 275(a) and 276 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Secs. 275 and 276) applicable to the taxable years 1939 to 1941, inclusive, are substantially the same as Sections 275(a) and 276 of the Revenue Act of 1938, *supra*, applicable to the taxable year 1938.

Current Tax Payment Act of 1943

Sec. 6. Relief From Double Payments in 1943

(a) Tax for 1942 not Greater Than Tax for 1943.

In case the tax imposed by Chapter 1 of the Internal Revenue Code upon any individual (other than an estate or trust and other than a non-resident alien not subject to the provisions of Sections 58, 59 and 60 of such chapter) for the taxable year 1942 (determined without regard to this section, without regard to interest or additions to the tax, and without regard to credits against the tax for amounts withheld at source) is not greater than the tax for the taxable year 1943 (similarly determined) the liability of such individual for the tax imposed by such chapter for the taxable year 1942 shall be discharged as of September 1, 1943, except that interest and additions to such tax shall be collected at the same time and in the same manner as, and as a part of, the tax under such chapter for the taxable year 1943. In such case if the tax for the taxable year 1942 (determined without regard to this section and without regard to interest or additions to the tax) is more than $50, the tax under such chapter for the taxable year 1943 shall be increased by an amount equal to 25 per centum of the tax for the taxable year 1942 (so determined) over $50, whichever is the lesser. This sub-section shall not apply in any case in which the taxpayer is convicted of any criminal offense with respect to the tax for

the taxable year 1942 or in which additions to the tax for such taxable year are applicable by reason of fraud.

Statement

The facts set forth in the statement of the case by the petitioner (Pet. 3-9) are essentially correct except that the corporation's deposits in the Sterling National Bank and the Public National Bank were not secret. These deposits were known to Monroe Dix as well as to others. What was unknown to Monroe Dix and the stockholders was that the transactions in these two banks were not reflected on the corporate books and the corporate tax returns.

The following additional facts are of moment to the determination of the issues.

The Statutory Notice of Deficiency, addressed to taxpayer by the petitioner, explains the other income being taxed to Jacob Dix as "this amount represents moneys received from funds withheld due to the corporation, J. J. Dix, Inc., during the year."

The parties to this proceeding have agreed that any money drawn by the taxpayer from the two omitted bank accounts of the corporation and not returned to or spent on behalf of the corporation was withheld from and is due to the corporation.

The relationship between Monroe Dix, Vice President and principal stockholder of J. J. Dix, Inc., and his father, Jacob Dix, deceased, was a continually strained one from 1935 on, often bordering on open litigation, and culminating in 1945 when Monroe Dix, after discovering that the records of the corporation did not reflect all of the sales, costs and expenses, compelled his father to agree to notify the Bureau of Internal Revenue of the facts in the case.

In the consolidated proceeding before the Tax Court, that Court found that Monroe Dix had not received any amount from the unreported sales proceeds as income.

J. J. Dix, has claimed from and discussed with the Executor of the Estate of Jacob J. Dix the return to the corporation of any amounts taken by Jacob Dix from corporate funds and not spent on behalf of the corporation. The Estate of Jacob Dix, in January 1952, had cash of $29,500 and marketable securities of the value of $17,000.

In 1945, the Port Morris Sales Company was organized, in which partnership the deceased taxpayer owned a 50% interest. From the time of organization until Jacob Dix died in 1948, that partnership earned very substantial amounts of money. The first fiscal year of the partnership ended in 1946.

J. J. Dix, Inc. did not declare any dividends from 1938 through 1945.

The Tax Court found as a fact that of the initially unreported sales of $196,870.60 of J. J. Dix, Inc. $140,133.78 was subsequently returned to the corporation during the years at issue and reported as sales income or spent on behalf of the corporation. Thus, the maximum amount that the deceased taxpayer could have received as income was $56,736.82. The Court then recognized that some portion of the unreported sales funds was also spent in over-ceiling payments to wastepaper dealers and possibly in over-ceiling wage payments, but did not further reduce the $56,736.82 for these items since the amounts could not be ascertained with regard to specific years.

Charles Carver, Special Agent, the only witness called by the Commissioner before the Tax Court, did not know whether or not the moneys claimed to have been spent by Jacob Dix for the account of J. J. Dix, Inc. were so spent.

The witness was not aware, and did not give any consideration to the fact that substantial amounts were paid into the corporation by the taxpayer and credited to sales income. Charles Carver instructed the Revenue Agent to set up the fraud penalties because it was the practice of his office to impose the fraud penalty wherever sales income is omitted. The fraud penalty was asserted against Jacob Dix for 1945 solely because he withdrew funds in 1945 from the Public National Bank account of the corporation.

The income tax returns of Jacob Dix for the calendar years 1938 through 1942 were filed on or before March 15, 1943. The appellant determined deficiencies against the taxpayer on November 9, 1949. The Estate of Jacob Dix pleaded that the deficiencies for the years 1938 through 1941 were barred by the Statute of Limitations and that the Current Tax Payment Act of 1943 discharged the 1942 tax liability.

Reasons for Denying the Writ

The issue in the present case is narrowly restricted to one of particular facts, and no amount of strained semantics can convert it into one of general principles warranting review by this Court on certiorari. The Court of Appeals, below, made this fact abundantly clear when after citing the principles involved in *Commissioner* v. *Wilcox*, 327 U. S. 404 and *Rutkin* v. *U. S.*, 343 U. S. 130, stated:

> "In the instant case the facts are close to those of Wilcox and lack the distinguishing features found in *U. S.* v. *Bruswitz*, 219 F. (2d) 59 (CA. 2) (Cert. Den. 349 US 913), and cases there cited."

The cases cited in *U. S.* v. *Bruswitz, supra*, are the very cases relied on by the petitioner in his request for certiorari.

What the petitioner alleges to be conflicting decisions was not so considered by the court below. That Court did not take issue with the decisions of other circuits in the particular cases referred to, but in its judicial wisdom found distinguishing features which made the principles and law expressed therein non-applicable to the case of the instant taxpayer.

The Supreme Court itself has apparently considered the line of demarcation between the *Commissioner* v. *Wilcox, supra,* and *Rutkin* v. *U. S., supra,* to be one of fact applicable to the particular case and has refused to disturb determinations of the Courts of Appeal in this field. *Briggs* v. *U. S.,* 214 F. 2d 699, Cert. Den. 75 S. Ct. 86; *Marienfeld* v. *U. S.,* 214 F. 2d 632, Cert. Den. 75 S. Ct. 87; *Kann* v. *Commissioner of Internal Revenue,* 210 F. 2d 247, Cert. Den. 74 S. Ct. 778; *U. S.* v. *Bruswitz,* 219 F. 2d 59, Cert. Den. 75 S. Ct. 600. In fact, this very principle of non-review of factual issues had been successfully urged in those cases by the petitioner in this case. There is therefore no reason why the Supreme Court should depart from its policy of refusing to review purely factual issues. To do so would lead to innumerable factual appeals and an increased burden upon the Supreme Court. This Court should not be led astray by spurious arguments that the decision in the case has created uncertainties in the lower Courts.

On the facts, the decision of the Court of Appeals in this proceeding was manifestly correct. Based on the findings of fact of the Tax Court, Jacob Dix, a non-stockholder, had misappropriated funds belonging to his corporate employer. This misappropriation was for his own personal use and benefit, to the detriment of the corporation and its stockholders and not approved or condoned by them.

These facts have been acknowledged in part by the petitioner and found to be entirely correct by the Court below. In fact, claim for the return of any misappropriated funds has been made by the corporation against the Estate of the deceased taxpayer.

There is no question that Jacob Dix did not receive these funds under a "claim of right" or that he was indebted to the corporation for the said amounts from the inception of the misappropriations. This has been admitted by the petitioner in his Statutory Notice of Deficiency addressed to the taxpayer and by stipulation before the Tax Court. On the basis of this latter fact alone the decision of the Court below can be sustained.

As in *Commissioner* v. *Wilcox, supra,* the deficiencies proposed against the Estate of Jacob Dix will more than offset the assets of the Estate and deprive the injured parties of any financial means of recovery. Moreover, the decision of the Court of Appeals in the case of this taxpayer undoubtedly had a bearing upon its decision in the companion case of *J. J. Dix, Inc.* v. *Commissioner of Internal Revenue,* wherein the Court denied a deduction to the corporation for embezzled funds in view of possible eventual recovery of its loss from the Estate. (This was obviously predicated upon the Court's reversal of the Tax Court in the case of the Estate of Jacob J. Dix.)

The decisions cited by the petitioner as being in conflict with that of the court below in the present proceeding are distinguishable on the facts. In none of the cases cited by petitioner did the Courts of Appeal hold as a matter of law that funds embezzled from an employer are taxable income to the embezzler. There is therefore no conflict on this issue among the circuits. The differences in facts from the *Kann* case are glaring.

In *Kann* v. *Commissioner, supra,* the taxpayers, two brothers, owned approximately 25% of the stock of the companies from which they allegedly embezzled funds and in addition were trustees of an additional 40% of the stock. The two brothers were the sole management of Pittsburgh Crushed Steel Co., the employer. In the instant case, Jacob Dix did not own, and except for qualifying shares, had never owned stock in J. J. Dix, Inc., and the management of the the company was divided between Monroe Dix, found to be a wholly innocent party, and the taxpayer. Jacob Dix only had a life interest in a trust which trust had a ⅓ interest, later reduced to a ¼ interest, in a voting trust of which a non-related person was trustee.

The Tax Court, as well as the Court of Appeals, in the *Kann* case stressed the fact that the imposition of the Federal tax deficiencies would not deprive the injured party from recouping what was due and both Courts believed this was an important factor in the Supreme Court decision in *Commissioner* v. *Wilcox, supra.* In the case of the instant taxpayer, the imposition of the proposed deficiencies will certainly deprive the corporation of any possibility of recouping misappropriated funds.

In the *Kann* case, the Court of Appeals stressed the Tax Court finding that there was "no adequate proof that the method, if not the act, has not been forgiven or condoned", and that the supposed liability to repay was "such as to leave serious doubt whether the whole project was not a false front erected to deceive not the corporation or its stockholders but the Commissioner of Internal Revenue." In the instant proceeding, there is no question that any misappropriation of funds has not been condoned and claim therefor has been made. The Court below held that the taxpayer's misappropriations were without the consent,

coerced or otherwise, of the company. That he was president did not amount to corporate consent.

In *U. S.* v. *Bruswitz, supra,* the taxpayer had been the recipient of commercial bribes and had not embezzled funds within the meaning of the New York penal law. It was this factor that lead the Court of Appeals to distinguish the facts from the *Wilcox* case, since there was no continuing obligation to restore the funds to an employer,—a liability which would have been subordinated to the Government lien had the tax been found appropriate.

In the *Bruswitz* case, the Court of Appeals said there was no indication that the kickbacks resulted in any loss to the defendant's employers.

In *Marienfeld* v. *U. S., supra,* the Court found that the taxpayer's fraud was not in fact embezzlement but the conversion of certain products of his employer to his own use and then the act of sale of those products for his own account. Thus the proceeds pocketed by Marienfeld had never been an asset of or in possession of the employer. In the case of the instant taxpayer, the Estate of Jacob Dix, the court below has found as a fact that Jacob Dix's misappropriations from the corporation were true embezzlement.

In *Briggs* v. *U. S., supra,* the Court of Appeals distinguished the facts from *Commissioner* v. *Wilcox, supra,* pointing out that Briggs was not an agent of the company, unquestionably received his share of the money in his own right and not as an agent or employee, and who could have been required to account for the money to the corporation only on the theory that he had participated in and abetted a fraud. Here again there was no embezzlement of moneys having been part of the assets of the employer. The facts are quite different from those in the instant proceeding.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

BERNARD WEISS,
Attorney for Respondent.

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